S. HRG. 112–521

OIL AND GAS TAX INCENTIVES AND RISING ENERGY PRICES

HEARING

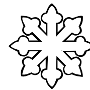
BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

MAY 12, 2011



Printed for the use of the Committee on Finance

OIL AND GAS TAX INCENTIVES AND RISING ENERGY PRICES

S. Hrg. 112–521

OIL AND GAS TAX INCENTIVES AND RISING ENERGY PRICES

HEARING

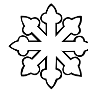
BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

MAY 12, 2011



Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

75–747—PDF WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON FINANCE

MAX BAUCUS, Montana, *Chairman*

JOHN D. ROCKEFELLER IV, West Virginia
KENT CONRAD, North Dakota
JEFF BINGAMAN, New Mexico
JOHN F. KERRY, Massachusetts
RON WYDEN, Oregon
CHARLES E. SCHUMER, New York
DEBBIE STABENOW, Michigan
MARIA CANTWELL, Washington
BILL NELSON, Florida
ROBERT MENENDEZ, New Jersey
THOMAS R. CARPER, Delaware
BENJAMIN L. CARDIN, Maryland

ORRIN G. HATCH, Utah
CHUCK GRASSLEY, Iowa
OLYMPIA J. SNOWE, Maine
JON KYL, Arizona
MIKE CRAPO, Idaho
PAT ROBERTS, Kansas
MICHAEL B. ENZI, Wyoming
JOHN CORNYN, Texas
TOM COBURN, Oklahoma
JOHN THUNE, South Dakota
RICHARD BURR, North Carolina

RUSSELL SULLIVAN, *Staff Director*
CHRIS CAMPBELL, *Republican Staff Director*

CONTENTS

OPENING STATEMENTS

Page

Baucus, Hon. Max, a U.S. Senator from Montana, chairman, Committee on Finance 1
Hatch, Hon. Orrin G., a U.S. Senator from Utah 3

WITNESSES

Watson, John, chairman of the board and chief executive officer, Chevron Corporation, San Ramon, CA 8
Odum, Marvin, U.S. president, Shell Oil Company, Houston, TX 10
McKay, H. Lamar, chairman and president, BP America, Inc., Houston, TX 11
Mulva, James, chairman and chief executive officer, ConocoPhillips, Houston, TX 13
Tillerson, Rex, chairman and chief executive officer, Exxon Mobil Corporation, Irving, TX 14

ALPHABETICAL LISTING AND APPENDIX MATERIAL

Baucus, Hon. Max:
- Opening statement 1
- Prepared statement 59
- "Description of Present Law and Select Proposals Relating to the Oil and Gas Industry," Joint Committee on Taxation staff report, May 11, 2011 (JCX–27–11) 62

Coburn, Hon. Tom:
- Prepared statement 86

Hatch, Hon. Orrin G.:
- Opening statement 3
- Prepared statement with attachments 92

McKay, H. Lamar:
- Testimony 11
- Prepared statement 101
- Responses to questions from committee members 104

Mulva, James:
- Testimony 13
- Prepared statement 125
- Responses to questions from committee members 134

Odum, Marvin:
- Testimony 10
- Prepared statement 180
- Responses to questions from committee members 186

Rockefeller, Hon. John D., IV:
- Prepared statement 201

Snowe, Hon. Olympia J.:
- Prepared statement 203

Tillerson, Rex:
- Testimony 14
- Prepared statement 205
- Responses to questions from committee members 208

Watson, John:
- Testimony 8
- Prepared statement 328
- Responses to questions from committee members 330

Page

Wyden, Hon. Ron:
  Prepared statement 364

COMMUNICATIONS

Blunt, Hon. Roy et al. 365
Logan, Coleen M. 370
National Association of Manufacturers 372
Texas Society of Certified Public Accountants 376

OIL AND GAS TAX INCENTIVES AND RISING ENERGY PRICES

THURSDAY, MAY 12, 2011

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:04 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Rockefeller, Wyden, Schumer, Stabenow, Cantwell, Nelson, Menendez, Carper, Cardin, Hatch, Grassley, Snowe, Crapo, Roberts, Cornyn, and Coburn.

Also present: Democratic Staff: Russ Sullivan, Staff Director; Lily Batchelder, Chief Tax Counsel; and Ryan Abraham, Professional Staff. Republican Staff: Mark Prater, Deputy Chief of Staff and Chief Tax Counsel; Curt Beaulieu, Tax Counsel; and Maureen McLaughlin, Detailee.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

In 2005, President George W. Bush said, "With $55 oil, we don't need incentives to oil and gas companies to explore. There are plenty of incentives." That was President Bush, 2005.

Today, oil costs more than $100 a barrel, so today we will again evaluate those oil and gas incentives. We will consider how they have affected profits in the industry and prices at the pump. We will ask the same question our 43rd President answered more than 5 years ago: is it wise to continue these tax breaks given to the largest oil and gas companies every year?

Gas prices are nearly $4 a gallon today, and experts anticipate they will remain close to $4 for the remainder of the season. That means gas prices are up more than $1 a gallon compared with last summer. In fact, families will pay an average of about $825 more for gas this year than they did last year. In rural areas like Montana where people drive farther, the increase is more like $1,200 per household.

At the same time, the five largest oil companies who are here today collectively earned more than $35 billion in profits the first quarter of 2011 alone. At this pace, 2011 will be their most profitable year.

Now business should, of course, make a profit. That is the American way. It is what drives our economy. But do these very profitable companies actually need these taxpayer subsidies? Energy in-

centives should help us build the energy future we want to see, not pad oil company profits. Americans want us to work toward an energy future made in America. They want us to develop energy resources that will not be depleted, like wind and sun. We cannot reduce using fossil fuels overnight; they are here for a long time. We must work with them to make them as clean as possible as we convert over to renewables. But investments in clean energy will move us away from the oil and gas bills that are squeezing consumers today.

To reach a clean American-made energy future, we have to scrutinize every dollar of energy subsidies we spend. The $2.1 billion we spend every year on subsidies for the largest oil and gas companies are not moving us closer to our energy goals. Everyone today finds their budgets are tight: families, governments, households.

Congress is also debating the best way to address our deficits and debt. Some are proposing cutting Medicare for seniors, others slashing Pell grants for students. I think all Americans agree, as we tighten our belts we all must sacrifice together, equally shared. So we have to take a hard look at every subsidy and every spending program to be sure we are using our dollars wisely.

In 2004, Congress created a Domestic Manufacturing Deduction often referred to as section 199. This deduction is designed to stimulate manufacturing here in America. In fact, I remember back when it was enacted to replace the Foreign Sales Corporation and Extraterritorial Income exclusion, or FISC/ETI. FISC/ETI was basically not used by the majors, so the 199 was essentially a gift given to the majors because they were not, according to my recollection—I could be corrected here—using the so-called FISC/ETI. So, 199 was essentially a gift.

Each company here today has claimed this deduction. What have taxpayers received in return? Have these tax breaks proven to be more valuable than Medicare or Pell grants? These tax breaks have not lowered prices. When these tax breaks were created, retail gasoline prices averaged about $1.80 per gallon. In fact, prices have increased. By 2008, prices had risen to an average of $3.26 per gallon. Last week, they approached $4.

These tax breaks have not moved us toward energy independence. According to a Treasury Department study in 2009, if all the subsidies for the oil and gas industry were eliminated, domestic production would fall by less than one-half of 1 percent. That is for the entire industry. Today we are only talking about the five largest, that produce only about one-third of domestic oil. The Big 5 have the most resources and are the least dependent on government subsidies, so the effect on domestic production from repealing these subsidies for these companies would be even less.

Despite these facts, some still argue that eliminating tax breaks for the largest oil and gas companies will raise prices at the pump or force layoffs. The oil and gas industry has launched ad campaigns arguing that repealing these tax breaks will hurt consumers.

But a 2007 Joint Economic Committee analysis found that repealing the oil and gas tax breaks would not raise energy prices for consumers. Would not. Why? Very simple. Oil prices are set on a world market. The U.S. share of production is only about 10 per-

cent. That makes it difficult, if not impossible, to pass on the cost of losing these subsidies to consumers.

Given profits of $35 billion in just the first quarter alone, it is hard to find evidence that repealing these subsidies would cut domestic production or cause layoffs. After all, based on first quarter profits, these tax breaks represent less than 2 percent of what these companies are on pace to make this year.

Even without these tax breaks, these companies clearly will be highly profitable. The chart here behind me to my right looks at financial documents that companies here today have filed with the Securities and Exchange Commission. These are in the footnotes and in the 10Ks and are basically documents filed with the SEC.

According to those documents, the average cost to produce a barrel of oil was about $11 in 2010. The average price these companies received for a barrel of oil was about $72. I will not say these are exact, but it is roughly what the SEC documents show.

Today, oil prices are higher, a lot higher, 40 percent higher, which would increase these large profit margins much further than shown on this chart. So it is hard to imagine that companies faced with these opportunities would cut production.

Now, some might argue that these subsidies or these record profits create much-needed jobs, but those same documents—public documents—filed at the Securities and Exchange Commission show that nearly 60 percent of these companies' 2010 profits went to stock buy-backs and to dividends, not to job creation. We can put this money to better use, I believe, and we should. We should use this money to reduce our deficit instead of putting the burden on seniors and our children's future.

These are choices, everybody. It is shared choice, it is America working together, looking at the facts and seeing the degree to which eliminating these subsidies would in fact be a fairer way for us to start to reduce our deficit, because reducing these subsidies, evidence shows, will have virtually no effect on jobs, or loss of jobs, in this country, for the reasons I have indicated.

So I just urge us to do what is right, what is wise for our country. This is one place we should examine, look at, see what the facts are. There will be lots of other areas that we are going to be looking at, not just the big 5 oil companies. Today we can only address one subject at a time, and the subject today is the one at hand.

[The prepared statement of Chairman Baucus appears in the appendix.]

The CHAIRMAN. Senator Hatch?

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

Senator HATCH. Well, thank you, Mr. Chairman.

Everybody is angry about high gas prices, and I can tell you that I am angry about it. The press keeps telling us that we need America to come together and put aside partisanship. Well, nothing makes for a Kumbaya moment like high gas prices. Republicans do not like paying high gas prices any more than Democrats do. With one voice, Americans are telling us to do something about them.

Unfortunately for some people, the political philosophy of Rahm Emanuel is too hard to resist, and that is: never let a crisis go to waste. So, faced with an issue of legitimate concern for the American people, politicians and their media allies decide to exploit high gas prices for political gain.

Now, this is a double game for those politicians. On the one hand, they are able to score some cheap political points against the politically unpopular oil companies. On the other hand, all of their sound and fury signifies nothing and is designed to distract their constituents from the simple fact that the Democrats have no energy policy whatsoever.

Let me take that back. Actually, they do have an energy policy. Are you ready for this? Their energy policy is to increase the cost of energy. You heard that right. This is the President's Energy Secretary, Steven Chu: "Somehow we have to figure out how to boost the price of gasoline to the levels in Europe."

So, while the American people ask Congress to do something about high gas prices, the response of Democrats is to rail against oil executives to mask the fact that their policy is actually to make the price at the pump more painful. For what it is worth, for all of their talk about the shrinking middle class and the income inequality, high gas prices do not hit Warren Buffett and Warren Beatty the hardest. They hit moms and dads who have to live far from where they work and drive minivans and SUVs because they have children.

When Al Gore has to pay a little more to gas up the private jet to fly to Cannes in France, he does not feel any pain. When my constituents in Utah see gas go above $4 a gallon, they have to make real choices about whether they have to work longer hours to make ends meet and whether they can send their children to camp this summer.

David Letterman captured this current situation brilliantly. Here is how Mr. Letterman put it: "Gas prices. Aren't they crazy? It's so expensive, the rats are carpooling in from New Jersey." Now, I would expect my friend from New Jersey to change the joke and stipulate that the rats arrived from the opposite direction. Of course, my friend from New York might take exception to that.

Now, we do not have as many rats in my home State of Utah, but, like folks in New Jersey and New York, Utahans are plenty angry about high gas prices. They are bearing the brunt of gas prices near $4 a gallon. This is very discouraging because we are still recovering from one of the worst recessions our country has ever faced, and all that these increased gas prices do is put the brakes on an already fragile economy.

Now, I hear from small businesses that they are trying to make a profit and possibly hire more workers, but now have to make room for added energy expenses. I hear from families who are trying to work out how these gas prices will fit in their budgets, and I hear from those who are still looking for employment.

What the people of Utah and this country need is a forward-thinking energy policy that will address rising gas prices that are a lead weight around the neck of the economy. I am not here to defend any particular industry. After all, I am one of the leading proponents of promoting alternative fuels. But let us not make any

mistake about what we are talking about here. I might add, I have passed legislation that does do exactly that.

Let us not gloss over the plan that is being offered here. The plan that is being offered here is to raise taxes. Americans are rightly upset about the cost of gasoline. And the solution being offered here? Let us raise some taxes. Lawyers would call this a non sequitur. Everyday Americans would call it beside the point.

Raising taxes to address high energy prices is about as relevant as a person walking into a doctor's office complaining of chest pain and having the doctor respond by offering to reupholster the patient's couch. Families and businesses are being hit by high gas prices. This demands an energy policy, but all this hearing is about is providing a justification for tax increases.

Now, I wish I could say I was surprised. No matter what the question is, it seems that for the President and some of my colleagues the answer is always, raise taxes. Government spends too much? Raise some taxes. Health care too expensive? Raise some taxes. Gas prices too expensive? I have it, let us raise some taxes!

I would be doing a grave disservice to my constituents if I was to ignore the consequences of these tax increases. Some of us are trying to create American jobs, increase energy supply, and reduce dependence on foreign oil at a time when we are still recovering from a historic economic collapse.

The proposals that will be discussed today are completely divorced from those pressing needs. The reasoning put forth for repealing these tax provisions—rising gas prices and reporting high first quarter profits—would set a bad precedent for future tax increases. Are we to increase taxes anytime a company sees an increase in quarterly profits due to high demand of a commodity? What if Wal-Mart's profits increased due to a spike in global demand for cotton? What if an increase in demand for coffee results in Starbucks reporting record profits? What if the Hollywood Studios hit a few home runs with some new films, and record profits result? Well, I am not going to hold my breath waiting for Democrats to haul George Clooney up here to justify his income.

I do not believe we really want to go down the dangerous road of deterring American businesses from becoming too profitable. This hearing should not be used to score cheap political points, but I am afraid, with all due respect, Mr. Chairman, that that is what we are going to see here today. I have a chart depicting what I expect this hearing to turn into, a dog and pony show. There you go. That is a really nice picture. I think that is pretty good, myself.

The CHAIRMAN. Who is the horse and who is the dog? [Laughter.]

Senator HATCH. I think we both know.

I know who the horse's ass is, I will put it that way. [Laughter.]

I should not have said that. My wife is going to give me heck when I get home, I will tell you. You will notice I used the appropriate term there.

Now, it is perfectly appropriate to examine the purpose, design, intent, and effectiveness of certain tax incentives that promote the domestic production of oil and gas. Let us have that debate. I am ready for it. Let us have it. In 2004, Congress passed the American Jobs Creation Act. The centerpiece of that legislation was the Domestic Manufacturing Deduction.

Now, this particular provision was designed to strengthen the domestic manufacturing sector. It is a deduction for manufacturing everything from coffee to appliances, to the domestic production of oil and gas. The amount of the deduction is specifically tied to wages paid to American workers. The intent was not to incentivize manufacturing and production, but to manufacture and produce within the United States rather than overseas. Congress passed this provision with the expectation that it would promote economic growth and job creation here in the United States.

Now, it is important to note that this provision is not just tied to oil and gas and to the oil and gas industry, but applies to income derived from all manufacturing within the United States. Maybe we should have a meaningful conversation about whether this provision is good tax policy. Given that it impacts industries far outside the scope of the oil and gas industry, it is a conversation more properly suited to a debate over tax reform.

But I am not going to hold my breath waiting for this adult discussion of tax policy. I know the distinguished chairman has been trying to do a series of hearings on tax policy, and I am personally very appreciative of that, and I applaud his leadership. Instead, though, I expect some good political theater here today. The liberal mouthpieces over at MSNBC certainly had the talking points yesterday afternoon, and they are ready to make some political hay at the expense of our witnesses today.

Many will point to a comment made by a former CEO that oil and gas companies do not need these tax provisions. That CEO might be right. Oil and gas companies would probably drill with or without these tax incentives. But let us be clear: they would be less likely to do so in the United States.

We have to ask whether we want to help increase the market share for U.S. corporations in the global oil and gas marketplace or do we want to decrease that market share and put ourselves at the mercy of foreign importers?

Now, I am not going to wait for the MSNBC lineup to put on their hard hats and stand on an oil rig and do a promotional ad asking this tough question about the potential loss of blue collar American jobs. We have a great number of resources that could be used to promote energy security within the United States.

I applauded President Obama's recent pledge to reduce foreign oil imports by a third by 2020. However, I was taken aback when he told Brazil that we want to be their best customers if they increase their oil production. So it is all right for other countries to boost the energy that would drive our economy, but it is wrong to produce it here at home?

To be honest, I do not know what the President and his administration's agenda is for energy security, and I do not expect to get any clarity on that point today. I think that is the point. The American people are upset at high gas prices and are demanding energy solutions. The President has no solution.

In fact, his policies would do precisely the opposite of what our constituents are asking for. They would increase the cost of domestic production and harm our economy. So, faced with the uncomfortable fact that the buck stops at the Oval Office and the President's only solution to high energy prices is to double down on

them, liberals are out to distract the American people from their failure to develop a coherent energy strategy.

Now, I do know that we currently depend on oil for our energy needs because it is abundant and it is dependable. Demand is, and will, remain high for the next decade, and certainly beyond that. There is a reason why Florida's demand for petroleum-based transportation fuels is among the highest in the United States. There is a reason why States like New Jersey and Maryland consume more gas per capita than most States. We certainly have the resources to meet that demand. Just recently, geologists have——

Senator ROCKEFELLER. Senator Hatch, are you almost through? I mean, you have been talking for a long time, and we do not have our testimony yet.

Senator HATCH. No, I am not through yet, but I am almost through, and I am not going to be through until I get through.

We certainly have the resources in this country to meet that demand.

Just recently geologists have discovered, in the western part of North Dakota and parts of Montana, a 25,000 square mile sea of oil that could hold the largest accumulation of oil identified in North America since 1968. They have dubbed it the Kuwait on the prairie. About 100 new oil wells are developed each month. We also have a great deal of oil in the Rockies on public lands and off our coasts, where the President has done everything in his power to shut down Federal leases in these areas. Maybe it is just the people working for him, I do not know.

Look, we all know politics is thick in the air here today. Our dog and pony will feel very much at home, I have to tell you that. Many Democratic Senators have admitted that it is good politics to take on oil companies when gas prices are high. We all know everyone is angry about high pump prices. We do not need to hold a hearing on that.

But, if we want to do something about it, three questions come to mind, and I will pursue these questions with the witnesses. The first question: will the policies proposed by the President and the Democratic leadership cause pump prices to drop? The second question: if pump prices do not drop, then what will the policies proposed by the President and the Democratic leadership do? One possibility might be that these policies will cause the U.S. to become more dependent on imported oil. The third question: with respect to tax incentives available for all U.S. manufacturers, is it wise—and this is an important question—to single out one industry and treat it differently from others? I will put a finer point on the question. Is it wise to conduct business tax reform on a selective and punitive basis? It is a legitimate question, and we ought to answer it.

Let us send the pony back to the stable. That is what we ought to do. Let us send the dog back to the kennel. Let us get back to reforming the tax code to support economic growth. So far this Congress, we have been making progress in making the tax code more efficient, simpler, and fairer, and I know that the chairman is dedicated to that, as am I, and I hope the chairman will continue in these efforts.

Thanks so much, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator.

[The prepared statement of Senator Hatch appears in the appendix.]

The CHAIRMAN. I would now like to introduce the panel before us. Our first witness is Mr. John Watson, chairman and CEO of Chevron; second, Mr. Marvin Odum, the U.S. president of Shell Oil Company; third, Mr. Lamar McKay, chairman and president of BP America; fourth, Mr. James Mulva, who is the chairman and CEO of ConocoPhillips; and finally, Rex Tillerson, chairman and CEO of Exxon Mobil.

So, Mr. Watson, why don't you begin? You probably know our customary procedure here is to have your statements included in the record. They will automatically be included. If you could then summarize for about 5 minutes. Thank you very much.

Mr. Watson?

STATEMENT OF JOHN WATSON, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, CHEVRON CORPORATION, SAN RAMON, CA

Mr. WATSON. Mr. Chairman, Ranking Member Hatch, and members of the committee, I am John Watson, chairman and chief executive officer of Chevron Corporation.

Affordable, reliable energy is the backbone of America's economy and competitiveness. Fortunately, our Nation is endowed with abundant supplies of energy, including oil and natural gas. Each time we come to Capitol Hill, we advocate for measures that would better help America develop our energy supplies.

More domestic supply, along with aggressive measures to use energy more wisely, is one of the most effective ways to counter rising energy prices, enhance our energy security, and stimulate economic growth. Tax increases on the oil and gas industry, which will result if you change longstanding provisions in the U.S. tax code, will hinder development of energy supplies needed to moderate rising energy prices. It will also mean fewer dollars to State and Federal treasuries and fewer jobs, all at a time when our economic recovery remains fragile and America needs all three.

Because my time is limited, I will make three points today. First, the oil and gas business pays its fair share of taxes. Despite the current debate on energy taxes, few businesses pay more in taxes than oil and gas companies. The worldwide effective tax rate for our industry in 2010 was 40 percent. That is higher than the U.S. statutory rate of 35 percent and the rate for manufacturers of 26.5 percent.

Between 2005 and 2009, our industry paid or accrued to the U.S. Government almost $158 billion in taxes, royalties, and fees, including $98 billion in Federal income taxes. That totals nearly $86 million a day. Changing important tax provisions outside the context of broader corporate tax reform would achieve one unmistakable outcome: it would restrain domestic development and reduce tax revenues at a time when they are needed most. Likewise, calls to raise royalty fees will increase the cost of doing business in places like the deepwater Gulf of Mexico and impede development of these resources just when we are getting back to work.

Second, longstanding oil and gas provisions in the tax code parallel tax treatment of other industries or are designed to prevent double taxation of income. For all U.S. businesses, a basic tax principle is that they are taxed on income after costs.

All companies in all sectors may deduct these costs in various ways. The oil and gas industry can deduct intangible drilling costs such as site preparation, labor, engineering, and design. These expenses are similar to the research expenses deducted by pharmaceutical and technology firms. These deductions allow companies to recover the costs of risky investments necessary for the viability of their business.

The tax provisions some seek to change are longstanding provisions in the tax code. Many apply to other segments of the U.S. economy, including the manufacturer's deduction and LIFO accounting. We are deeply concerned about proposals to curtail foreign tax credits for dual-capacity taxpayers. Credits for foreign income taxes are critical because, without these credits which are available to all taxpayers, we would pay tax twice on income generated overseas. This would make us less competitive internationally and cost U.S. jobs that support our overseas operations.

My third point is that there should be equitable treatment for all forms of energy and for all energy producers, large and small. I am an advocate for developing all forms of energy and using energy more wisely, but it is wrong to increase taxes on oil and gas companies to subsidize other forms of energy. This is also likely to have serious unintended consequences for production, jobs, and revenues.

Singling out five companies because of their size is even more troubling. Such measures are anti-competitive and discriminatory. After all, our five companies are providing the technical, operating, and managerial expertise that is allowing the global energy industry to operate at the forefront of energy development.

Let me close by suggesting that the most sensible path is simple: do not punish our industry for doing its job well. Create energy and tax policies that make our country a more attractive place to do business. Allow us to develop our Nation's vast energy resources. And strengthen, do not weaken, our ability to compete against large national oil companies who are major players in the U.S. and global energy markets. Responsible development of our resources, which will be enabled by sound tax and energy policy, will add more high-paying jobs, provide billions in new tax revenues, and reduce our dependence on foreign energy supplies.

If our Nation's concern is keeping investments here at home and ensuring reliable, affordable energy for all Americans, what we ask for here is what we look for anywhere we invest: conditions that are not punitive and discriminatory, but stable, transparent, and equitable.

Mr. Chairman, I am proud to lead a 132-year-old American company, I am proud of the vital role we play in our economy, and I am proud of the profits allowing us to make significant investments in our communities and the long-term health of our country.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Watson.

[The prepared statement of Mr. Watson appears in the appendix.]

The CHAIRMAN. Mr. Odum, you are next.

STATEMENT OF MARVIN ODUM, U.S. PRESIDENT, SHELL OIL COMPANY, HOUSTON, TX

Mr. ODUM. Thank you, Chairman Baucus, Ranking Member Hatch, and members of the committee. I am Marvin Odum, president of Shell Oil Company. Shell is a global energy company with more than 90,000 employees in 90 countries—approximately 19,000 of those are here in the U.S.—working to discover, produce, market, and deliver to consumers today's energy and tomorrow's energy technology. Thank you for the opportunity to speak to you today.

I would like to address right up front the issue that is on many Americans' minds, the rising cost of energy, particularly the cost of gasoline. Because fuels are refined from crude oil, the biggest impact on the price of fuel is the price of crude oil. Everything from weather to politics in the global economy determines the price of oil and the fuels made from it.

Weak economic conditions in 2008 and 2009 lowered demand, which helped push prices down. Now, with worldwide economic recovery under way, demand is on the rise, sending prices upwards. In addition, because oil is sold in U.S. dollars throughout much of the world, when the dollar becomes weaker, it takes more dollars to buy the same amount of oil.

Simply stated, oil is a global commodity, so, while we cannot predict or control the price at the pump, we do know that we can increase the stability of our energy future through a combination of efficiency gains and increased supply.

The surest way to address a challenge of this magnitude is to focus on what we can control, using what we know to safeguard against what we do not. Without question, our government is facing significant challenges right now, particularly in terms of economic and energy security. But, when you face a deficit, be it energy or financial, choices are usually straightforward: get more or use less. Often it is a combination of both that achieves the best results. There are choices on how to get more.

I think it could be tempting to assume that there is something to gain by taking more from a few; however, one must also balance the implications of increased industry cost on both supply and the cost of fuel. The opportunity in front of us is to put policies in place that allow the energy industry to become an economic growth engine for America. Developing our own resources, we would see tens of thousands of new, well-paying jobs and many, many billions of dollars in revenue for local, State, and Federal Governments.

Some perspective. Last year, Shell reported global earnings of $18.6 billion. We also invested some $29 billion, mostly in new projects, to bring energy supply to the consumer. In addition, we spend more than $40 billion to run our existing businesses worldwide.

Last year in the Gulf of Mexico, government policies caused Shell to defer some $700 million in capital expenditures. We expect to lose an estimated 50,000-barrel equivalent per day in 2011 alone as a result of that.

Now, thinking about that impact to date, it represents lost gasoline production just to Shell that could have powered, on average, 633,000 cars and light trucks every day since January 1.

Now, here in the U.S., at the invitation of the Federal Government, we have invested more than $3.5 billion since 2005 to develop energy resources in Alaska. Six years later, we have been prevented from drilling a single exploration well due to the government's inability to deliver timely permits to allow this potential new resource to be developed. During that time we have drilled more than 400 exploration wells worldwide.

My point is this. Investments in our industry carry huge amounts of capital and risk. Policymakers must consider this when thinking about the competitiveness of the U.S. relative to other regions. The President recently acknowledged that reducing dependence on certain imports was a national policy imperative. We agree. The U.S. is resource-rich in many ways, especially in oil and gas.

Yet, as a country we import more than 60 percent of our petroleum at a cost of more than $350 billion a year. The bottom line is this: if we do not develop our own energy sources, we will have to accept the cost, both financial and geopolitical, of bringing it into this country from places that can be less secure and less stable.

In closing, Shell is grateful for the widespread recognition in Congress of the daunting energy challenge facing this Nation. Although some of our opinions differ, we stand ready to work with you on developing a more secure, affordable, and efficient energy supply for this Nation. Thank you.

The CHAIRMAN. Thank you, Mr. Odum, very much.

[The prepared statement of Mr. Odum appears in the appendix.]

The CHAIRMAN. Mr. McKay?

STATEMENT OF H. LAMAR McKAY, CHAIRMAN AND PRESIDENT, BP AMERICA, INC., HOUSTON, TX

Mr. MCKAY. Thank you, Mr. Chairman, Ranking Member Hatch, members of the committee. Good morning. My name is Lamar McKay, and I am chairman and president of BP America. I appreciate the opportunity to address the issue of energy tax incentives today. Before doing so, I want to recognize that last month marked 1 year since the Deep Water Horizon accident, and BP continues to work very hard to meet our commitments in the Gulf.

Now, I would like to provide just a little bit of context on BP's operations and investments in the U.S., both in traditional and renewable energy. BP has a very long history in the United States, over 100 years, with 23,000 U.S. employees and operations spread across the country.

We are committed to providing the U.S. with the energy it needs to grow in the coming decades, and doing so in a responsible and sustainable manner. We are one of the largest oil and natural gas producers in the U.S. and one of the Nation's largest energy investors.

Now, over the 5 years ending in 2009, we have invested more than $37 billion in development of U.S. energy supply. We continue to invest in natural gas production from the Rocky Mountain west and our existing shale gas regions. We have significant oil production in Alaska and the Gulf of Mexico.

Further, we have made, and are continuing to make, significant investments in our refineries in the U.S., including major capital projects that will increase gasoline production capacity at our key midwestern refineries. We also invest actively in renewable energy. During 2009, we invested nearly $1 billion, or 10 percent of our $9.9 billion dollars of U.S. capital budget, in alternative energy.

These investments include the operation of wind farms in 10 States, development of the first commercial-scale cellulosic biofuels facility in Florida, and work on an advanced biofuels molecule, biobutenol, with DuPont. We have our solar business, which has been in operation for over 35 years.

BP supports a comprehensive energy policy that includes all forms of energy, including oil, natural gas, coal, nuclear, biofuels, wind and solar, and encourages efficiency and conservation. The reality is that, even with major improvements in energy efficiency and the rapid growth of biofuels, wind, and solar, 20 years from now in 2030, the United States will still depend on oil, natural gas, and coal to meet more than three-quarters of its energy needs.

On the supply side, we support properly scaled transitional incentives for alternative energy, but raising taxes on one form of energy to encourage production of another will reduce industry's ability to keep up with growing U.S. energy demand. The result could be less investment, less production, tighter energy markets, and over time, potentially higher prices for consumers. Instead, our Nation should be encouraging production of all forms of energy, including oil and natural gas.

On the demand side, energy policy should encourage conservation and help drive energy efficiency. The energy challenges facing the U.S. are enormous. The impacts of high energy prices on the overall economy and the American people are very real. We cannot change the international crude oil market which drives those prices and on which the country relies for more than 60 percent of the oil it consumes, but we can work with the Congress, with the administration, and consumers across the Nation to move towards greater energy security and a lower carbon energy future.

Congress establishes the rules regarding energy and tax policy. Companies take those rules into account in making their investment decisions. Given the cost and the long-term nature of the significant capital investments that are required to develop and produce energy, a stable and competitive tax framework is critical to the United States remaining attractive in the global demand for capital investment.

The currently contemplated changes to the tax rules would limit the resources companies like BP have to invest, not only in conventional energy production, but also in new and emerging technologies like wind, biofuels, and solar. BP is very serious about bringing new sources of oil and natural gas to the market. We are also serious about building a sustainable, profitable alternative-energy business capable of delivering clean, affordable power. My company stands ready to work with you and others to address the energy and environmental needs of this Nation. Thank you.

The CHAIRMAN. Thank you very much, Mr. McKay.

[The prepared statement of Mr. McKay appears in the appendix.]

The CHAIRMAN. Mr. Mulva, you are next.

STATEMENT OF JAMES MULVA, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CONOCOPHILLIPS, HOUSTON, TX

Mr. MULVA. Good morning, Chairman Baucus, Ranking Member Hatch, and committee members. My hope today is to bring clarity to this vital debate on tax policy regarding the major oil companies.

To begin, there is a great deal of misinformation about our tax liabilities, and unfortunately it is being used to justify further increases. So my objective is to convey, first, the realities of our current tax burden, and second, the negative impacts of new proposals, for there would be impacts to our company, our industry, American consumers, U.S. job creation, and national energy security.

So, let us take a look at what we already pay. I have a chart that we are pointing to that shows the effective worldwide tax rates of the 20 largest U.S. non-financial companies. There are a lot of familiar names on this chart. On average, the group paid 27 percent for the years 2006 to 2010. But look at those three on the top.

The CHAIRMAN. Mr. Mulva, if you could identify a few. I cannot read some of those over on the left. If you could just outline two or three during your testimony, that would help.

Mr. MULVA. All right. It comes after the three oil companies: Wal-Mart, Berkshire Hathaway, Apple, Intel, Microsoft.

The CHAIRMAN. Who is down at the bottom?

Mr. MULVA. The bottom? GE, Pfizer, Merck, Verizon, Coca-Cola, Cisco.

The CHAIRMAN. Okay. Thank you.

Mr. MULVA. So you can see at the top, ConocoPhillips is 46 percent, followed by the two international American companies. The three major U.S. oil companies already pay the highest effective tax rates in the top 20. Keep in mind, this is after taking the allowable tax deductions and credits.

What does this mean in hard dollars? Well, for our company, we earned $11.4 billion last year and we paid $8.3 billion in income taxes, as well as $3.1 billion in other taxes. So our total worldwide taxes paid actually equaled our income. So any fair-minded person would likely agree that we pay our full share.

Remember, too, that companies like ours carry the flag of U.S. competitiveness into the battle for global business, and every day we fight for access to energy resources and opportunities around the world. Our rivals are typically nationally owned companies from other countries, and they literally dwarf us in size. Some are dozens of times bigger than we are, and they enjoy explicit support from their governments.

Despite these compelling numbers and despite the need to maintain a competitive U.S. oil industry, some would have us pay even more. In fact, one proposal would only impact the three major oil companies that already carry the heaviest burdens and would further restrict the foreign tax credits that are available to us, so it would seriously undermine our ability to conduct our business internationally. That is because, when we decide how much to bid for foreign energy opportunities, we have to include taxes among the total project cost when we make these investment decisions.

So, all else being equal, overseas companies with lower tax obligations can outbid us and win the opportunities. Unfortunately,

this does impact U.S. jobs. For our company, we operate worldwide with 29,000 employees, of which 20,000 are right here at home, and some of them, 3,000 U.S.-based employees, work to support what we do internationally around the world.

So reducing foreign tax credits will have a cascading effect on our business. We would lose projects and opportunities to foreign competitors. Cash flows that would otherwise generate tax revenue here would instead go elsewhere. Our U.S. job creation and investments would suffer. Further, as profitability declined, it would reduce our ability to invest in domestic energy, and ultimately we could even see more energy and development here conducted by foreign competitors, which, by the way, would inevitably send dollars back to their home countries.

We currently hear a lot about the so-called tax subsidies. This calls for another reality check. The major companies do not get special subsidies. In fact, some deductions and credits available to the industry are not allowed to the three major companies, and the ones we are allowed either match or closely mirror those available to all U.S. companies. Even in these cases, the law limits how much we can benefit. That hardly sounds like special industry subsidies.

Congress and the administration often speak of enhancing U.S. competitiveness, but enacting the foreign tax credit restrictions and other proposals would be very counterproductive. They would penalize U.S. workers and the American public who invest in our shares, and they would harm the well-being of companies like ourselves that must carry our country into the energy future. That certainly cannot be your intent, so I urge you to objectively and dispassionately consider the facts and reject these unfair and unwarranted tax proposals. Thank you.

The CHAIRMAN. Thank you, Mr. Mulva.

[The prepared statement of Mr. Mulva appears in the appendix.]

The CHAIRMAN. Mr. Tillerson, you are next.

STATEMENT OF REX TILLERSON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, EXXON MOBIL CORPORATION, IRVING, TX

Mr. TILLERSON. Chairman Baucus, Ranking Member Hatch, members of the committee, I appreciate the opportunity to address the topic of today's hearing: "Oil and Gas Tax Incentives and Rising Energy Prices."

All of us here today recognize the strain that high gasoline prices impose on many Americans, particularly during difficult economic times. We owe it to our customers and to your constituents to address the topic of energy prices and taxes in an open, honest, and factual way. Unfortunately, the tax changes under consideration that target the five U.S. companies represented here today fail to honor those goals.

It is not simply that they are misinformed and discriminatory: they are counterproductive. By undermining U.S. competitiveness, they would discourage future investments in energy projects in the United States and therefore undercut job creation and economic growth. Because they would hinder investment in new energy supplies, they do nothing to help reduce prices.

There is a more effective way to take steps to reduce prices and raise revenues, but unfortunately it is a way Congress and the administration have so far rejected. If the U.S. oil and gas industry was permitted to develop our Nation's enormous untapped energy supplies, it would put downward pressure on energy prices and increase revenues for government budgets.

Working together, industry and government can achieve our shared goals. In that spirit, I would like to offer several important facts on the specific tax proposals that are currently being advocated by some in Washington.

First, it is important to make clear that tax provisions such as the section 199 Domestic Production Activities Deduction are not special incentives, preferences, or subsidies for oil and gas, but rather they are standard deductions applied across all businesses in the United States.

Section 199 applies today to all U.S. domestic producers and manufacturers, from newspaper publishers to corn farmers, to movie producers, and even coffee roasters. All can claim this deduction which is intended to support job creation and retention in the United States.

By any reasonable definition, it is not an oil and gas industry incentive. In fact, our industry is currently limited to only a 6-percent deduction, while all other U.S. manufacturers are allowed a 9-percent deduction. Frankly, to then deny a select few companies within the oil and gas industry this standard deduction is tantamount to job discrimination. Why should an American refinery worker, employed by a major U.S. oil and gas company in Billings, MT, be treated as inferior to an American movie producer in Hollywood or an American newspaper worker in New York, or an employee of a foreign-owned refinery in Lamont, IL?

Another tax measure that is misleadingly labeled a subsidy is the foreign tax credit provision which upholds a basic tenet of tax fairness by preventing our overseas earnings from being double taxed. This provision applies to all U.S. companies with overseas income and has been in place since 1918. It is meant to protect U.S. competitiveness abroad.

Again, U.S. oil and gas companies are already treated differently from other businesses under this provision, which includes unique and proscriptive rules on our industry, requiring us to actually prove our foreign tax payments are indeed income taxes and not royalties.

If these rules were changed and the foreign income for select U.S. oil and gas companies like Exxon Mobil were to be double taxed, our foreign-based competitors and the full range of foreign government-owned oil companies would gain a significant competitive advantage.

Clearly, these tax provisions and others under consideration are not special industry incentives or subsidies. They are economy-wide, generally available deductions and credits under the tax code. Removing them for a select few U.S. oil and gas companies is therefore nothing less than discriminatory and a punitive tax hike which jeopardizes the jobs of American workers.

Doing so would also do nothing to reduce the prices Americans pay at the pump. Gasoline prices are primarily a function of crude

oil prices, which are set in the marketplace by global supply and demand, not by companies such as ours. Furthermore, arbitrarily punishing five U.S. oil and gas companies by raising their taxes will generate far less government revenue than if we were allowed to compete and produce our Nation's own resources.

An August of 2010 Wood Mackenzie study estimates that approximately $10–$17 billion in direct upstream investment in this country is at risk per year if the section 199 and other tax provisions are repealed for our industry. Another recent Wood Mackenzie study found that opening up Federal lands that Congress has kept off-limits for decades could generate 400,000 new jobs by the year 2025. Another analysis shows that such actions could generate as much as $1.7 trillion in government revenue over the life of those resources.

The fact is, raising taxes on five U.S. oil and gas companies is simply not the way to reduce prices or raise revenues. Increasing these companies' taxes would only discriminate against certain U.S. workers and make our companies less competitive against others who are in the same business that we are in, and discourage future energy investment in this country.

A much better solution lies in permitting our industry to increase energy supplies, including supplies found here in North America, such as oil and natural gas found off our shores and in our shale formations. Access, not taxes, will enable us to meet the goals of increasing affordable energy supplies for Americans, strengthening U.S. energy security, and powering our Nation's economy forward. Exxon Mobil shares these goals, and we look forward to working with you to achieve them.

Thank you.

The CHAIRMAN. Thank you, Mr. Tillerson.

[The prepared statement of Mr. Tillerson appears in the appendix.]

The CHAIRMAN. Gentlemen, I appreciate your taking the time to come here. Let me tell you my perspective, which is, as chairman of the Finance Committee—and I speak for all members of Congress—we have to find ways to reduce our annual deficits and our debt. That is not an easy task. To do so, we have to find an approach that is balanced across the board. There are lots of interests, lots of competing areas where we can cut. We all know that, so we have to find a fair solution, one that is shared by Americans or perceived by Americans to be pretty fair, pretty balanced, within the bounds of reason.

What you said, Mr. Tillerson, and what you all said, in many respects is true: you do pay high taxes. That is true. But it is also true your foreign taxes are higher than your domestic taxes. That chart showed the worldwide rate. Your domestic tax rate is quite a bit lower than your worldwide rate.

It is also true that the price of gasoline is determined primarily by the world price of crude. That is the primary determinant. The world price goes way up, gasoline prices go up. But it is also true that, when the world price goes up, the after-tax profits of your companies go up very significantly because your costs do not go up as much, at least in the last year or so, as the world price of crude

has gone up. When world crude prices go up at such a high rate, then your profit margins go way up. That is true.

It also seems to me, based on the evidence, that, according to your financial reporting statements, if your average cost is roughly $10, $11 a barrel, if you add in intangible drilling, maybe it goes up to closer to $20 a barrel. But in 2010, your after-tax profits were about 72 bucks. Your gross revenue was about $72 a barrel, and this year it is much higher. So it just looks, according to the evidence, like this is not a matter of singling anybody out. It is just your companies, and how much gross profits you make.

It is not based on your subsidies; it is based on the world price of crude. That is what it is really based on. Maybe a fair way to get at reducing our deficit and our debt is to reduce, tail back, if not eliminate, the tax breaks which do not have much effect on your decisions to produce. It does not have much effect because your profits are so high.

Again, according to the reports, Exxon Mobil, for every dollar increase in the price of crude—Exxon Mobil's after-tax profits were up to, I think, $375 million a year. If you add all five of you together, for every $1 increase in crude, your after-tax profits go up $1 billion all together, totaling it all up. The subsidies we are talking about here, they are $21 billion over 10 years, roughly $2 billion a year. Break that down to a quarter. That is $500 million. This is rough. I grant you, this is rough.

But if the price of oil should go down $2 a barrel, that would be more than the elimination of these subsidies. So these subsidies really do not have much effect in your decisions of where to produce. It is the profits you have and the rate of return you are going to get in different locations that really, I am guessing, have a much greater effect on your ability to produce.

So tell me what is wrong with my analysis. It just seems, frankly, that you are making a lot of money. That is fine. It is the American way. But it also seems that maybe the subsidies are not really that necessary any more. Many of them were given many years ago.

Mr. Tillerson, 199 is really the aftermath, as we all know, the substitute for FISC/ETI. FISC/ETI was intended to give American companies a break, an export break. WTO ruled it illegal, so Congress passed 199 for everybody. It is my recollection that the FISC/ETI really wasn't used very much by you guys, so it was kind of a gift, 199. Other companies do use it for export, in effect, whereas you do not as much.

So I just ask the question. I do not know who wants to answer it. It just seems to me, as we try to get our deficits and debt under control, with oil prices so high and because the subsidies are so low compared to the increase in crude oil prices, that you do not need it nearly as much as one might initially think. I will let anybody go ahead.

Mr. ODUM. Well, I will make just a couple of points here.

The CHAIRMAN. My time has expired. I am sorry. So just very, very briefly.

Mr. ODUM. So just a couple of quick points. I think, first of all, if you look at ways to impact the deficit, and you think about this in terms of a word used a lot these days, which is sustainability,

the way to impact the deficit and get more money into the Federal Government is through more production, where we pay more bonuses for the access, we pay more royalties on the production. Those numbers are potentially much, much larger than anything we are talking about here. That is the way I think to impact the deficit beast.

I did want to comment on your production cost chart, just because I think it misses a pretty important point, which is the investments that have to be made to produce oil and gas that have those kind of ongoing production costs. So it does not include, not only the huge investments, the billions of dollars that go in, but also the time lag for when those investments start, to when that production actually starts to happen. The other piece I think it probably misses is that it looks at all of the existing production that exists across the country today, I would assume by what you said. The cost of future production is not the same as the cost of historic production that is currently online. It is more expensive now.

The CHAIRMAN. Thank you.

Anybody else? Mr. Tillerson?

Mr. TILLERSON. Well, I think it is helpful if we kind of think about, are we going to talk about the past or are we going to talk about the future, because a lot of the numbers you are displaying—and they are not entirely accurate in terms of total cost as Marvin said—are really talking about things in the past and what we have already done.

We are in the depletion business, so we invest in resources that deplete, so we constantly must replace those if we want to have a sustainable business. We have been around for almost 130 years. You heard John Watson say 130 years. So that is what we have been doing for more than a century, is taking the revenues from the past decisions and finding ways to invest them to replace the barrels that are depleting.

As we have to go out and find and locate those replacement barrels, they are more and more difficult to find. The real question is not, can we afford more taxes. If we are never going to invest anymore and we are just going to liquidate the company, there is going to be a lot of revenue around.

But that is not what we are doing. We are sustaining the viability of the enterprise for many years to come, so we have to make very large investments. The real question is, what do these tax changes mean to that next incremental investment decision we are going to make? That is made on an asset-by-asset, investment-by-investment basis.

So in the United States, if I want to look at a Shell oil lease in North Dakota, I have to run the cost of acquiring those leases and drilling and developing and producing and paying all of that, and I have to put the tax burden on that. You give me a different tax burden than my competitor has, and I do not get to develop that lease.

I am going to take my capital then, since the U.S. is not attractive, and I have to go somewhere else offshore. If you want to raise the incremental cost of royalty or development costs or taxes on the

next investment decision, it is that marginal barrel that you are going to take out of our system.

The CHAIRMAN. All right. I wish I had more time, Mr. Tillerson. My time has more than expired. This is not the greatest forum in the world to get into deeper depth.

Senator Hatch?

Senator HATCH. Well, thank you, Mr. Chairman.

Now, this question is for the entire panel. I would like you to answer yes or no, if you can. You can certainly add to it if you want.

As you know, President Obama and numerous congressional Democrats have proposed raising taxes on United States oil and gas production. However, an Associated Press article from Tuesday about Senator Menendez's bill to increase taxes on oil and gas stated, "Menendez acknowledged that the legislation—slated for a vote next week—won't do anything about gas prices exceeding $4 a gallon in many places."

Now, with rising taxes on United States oil and gas production, will raising taxes on oil and gas production lower the price of gas at the pump? Are you aware of any good or service that has become less expensive as a result of being taxed more heavily? If we could just start with you.

Mr. WATSON. Senator, directionally, raising taxes on producers raises the cost of crude oil. The cost of crude oil is the prime ingredient in the price of gasoline, so raising our taxes will not reduce the price of gasoline.

Senator HATCH. All right.

Do you all agree with that?

Mr. ODUM. I certainly do agree with that. I think the bigger point behind it is, if the production here in the U.S.—either you do not have access to it or it is disadvantaged relative to other opportunities in the world—moves somewhere else, the jobs move somewhere else, the trade benefits move somewhere else, all the attendant benefits go away as well.

Senator HATCH. All right.

Mr. MCKAY. No, I do not believe, obviously, that raising taxes will lower prices. I do think the important thing is to have a competitive fiscal environment to attract investment. More investment can raise supply and have an effect on prices.

Senator HATCH. All right.

Mr. MULVA. Raising taxes will lead to less investment, less production, and most likely higher cost per gallon and less employment.

Senator HATCH. All right.

Mr. Tillerson?

Mr. TILLERSON. It is going to have little immediate effect, but the effect will come in the months and years to come in terms of raising the cost of development here. If a loss of, like, 199 deductions puts more pressure on refining margins—refineries already lose money most quarters, so, if we lose more refinery capacity in the U.S., it means more imported product rather than refining product here.

Senator HATCH. Let me ask this question. My colleague from the State of New Jersey, Senator Menendez, recently introduced a bill that would increase taxes on the top 5 integrated oil companies,

meaning your companies. He said in his statement that these so-called subsidies "only benefit big oil and CEOs."

Now, I would like to point out to my friend that actually corporate management, as I understand it, only makes up about 1.5 percent of the shareholders. In fact, 41 percent of the shareholders are individual retirement accounts, if I am right on this, or pension funds. There is a chart showing the top 10 holdings of the New Jersey Public Employee Pension Fund. Now, I would just point to this. As you can see, Exxon Mobil and ConocoPhillips are listed among the top 10 holdings.

Now, my question to you, Mr. Mulva and Mr. Tillerson, is, would increasing taxes on your company affect your earnings?

Mr. MULVA. Increasing taxes obviously would have an impact on our earnings, and ultimately on the value of our companies and the valuation and the share performance to our shareholders, so it would have an impact with respect to these shareholders.

Senator HATCH. And all these pension funds.

Mr. MULVA. To the pension funds.

Senator HATCH. And New Jersey is not the only State that has pension funds.

Mr. MULVA. That is true. If you take all Americans and retirees and employees, if they are involved in one way or another directly or indirectly with a pension fund, they probably are a shareholder in an oil and gas company.

Senator HATCH. Do you agree with that, Mr. Tillerson?

Mr. TILLERSON. Yes. Raising the taxes obviously would affect our cash flow that is available to pay dividends, which go back to the pension companies and institutions that own our shares and can affect the overall cash flow and financial management of the company.

Senator HATCH. One last question in the time that I have. I am sure that you are aware that the United States already has the highest statutory corporate tax rate among OECD countries. Now, according to Compustat, a database that collects information from companies' financial statements, the oil and gas industry has an effective tax rate of 41.1 percent, while other industrial companies have an effective tax rate of 26.5 percent.

Yours is a very high tax rate. All of the tax increases we are talking about today would eliminate incentives to produce oil and gas within the United States, it seems to me. Now, do these tax increases encourage you to produce oil and gas and move jobs and investment outside the United States rather than doing it here? Any one of you can answer that.

Mr. WATSON. Certainly tax is a big cost of doing business for us, and it is considered in all the decisions that we make. To the extent that taxes are higher in the United States, we will look elsewhere. To the extent that foreign tax credits are limited, it would be even more difficult for us to compete overseas as well. So, with all the provisions that have been considered, it will make it more difficult for us to do business, raise the cost of doing business, ultimately produce less in revenue for the U.S. Government, fewer jobs, and move against the President's agenda of reducing imported oil.

Senator HATCH. All right. My time is up, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Wyden, you are next.

Senator WYDEN. Thank you, Mr. Chairman.

Gentlemen, as you know, this is not the first time the Congress has dealt with this issue. Five years ago, those who were serving as CEOs then of your companies were asked—I specifically got into it—whether they agreed with President Bush's statement, "With $55 oil, we don't need incentives for oil and gas companies to explore." Conditions today are pretty much like they were in 2005: record profits, price hikes, certainly above inflation. Mr. Mulva, you will recall, you were at the hearing.

What I would like to do, briefly, for the committee, Mr. Chairman, is actually replay the portion of that hearing where the oil company CEOs said they did not need incentives from the Federal Government when oil was at $55 a barrel. If we could just show that video briefly.

[Whereupon, the video was shown.]

Senator WYDEN. Gentlemen, the reason I wanted to get into this is today's conditions are much like they were in 2005. That is why I mentioned the profits—certainly the prices are far in excess of inflation. Mr. Mulva, you were there. You specifically said, in 2005, "Senator, with respect to oil and gas production, we do not need incentives." So oil is now right around $100 a barrel. My question—and I want to start with you, Mr. Mulva, because of your history—if your company did not need incentives to drill for oil at $55 a barrel, how in the world can you possibly need incentives when oil is at $100 a barrel?

Mr. MULVA. Well, two aspects of that question. First, at $55 going to $100, we look at the past. The easy-to-find oil has already been found. Our costs go up, taxes have gone up. Oil is more difficult to find, more challenging, our costs have changed. I would also say that, in response to the question several years in the past, we do not view the items that we are talking about—foreign tax credits, section 199, and intangible development costs—as subsidies. We essentially view those as similar types of provisions that are made available to other companies, all industries, in a similar way. So we do not need incentives to drill, just as I said several years ago.

Senator WYDEN. Mr. Mulva, then, as now, I am talking about industry-specific incentives: percentage depletion, intangible drilling costs, geologic and geophysical costs. These are industry-specific incentives. You all said you did not need them in 2005. Markets, by the way, were global in 2005 just as they are now. I just cannot understand how, even if you account for all the possibilities in the world, how you can make the case that you need these industry-specific incentives when oil is at $100 a barrel when you told me you did not need them at $55.

Mr. MULVA. Essentially, intangible development expenses, we view these essentially similar to research and development technology, similar types of provisions that are made available to other industries.

Senator WYDEN. No. Those are industry-specific incentives, sir. They were in 2005, they continue to be today.

Mr. MULVA. Yes. But they are very similar to what is offered to other industries as well.

Senator WYDEN. And I would note, you also get the R&D credit as well.

But let me just go right down the row. Mr. Watson, your predecessor at Chevron said that he did not need incentives as well at $55 a barrel.

Mr. WATSON. Senator, I would like to offer several comments. First, in response to a couple of things you said. You talked about percentage depletion. These companies are not eligible for percentage depletion, so perhaps there is some confusion about what we are eligible for.

Senator WYDEN. We are talking about industry-specific provisions.

Mr. WATSON. Right.

Senator WYDEN. That is what the President was talking about in 2005. That is what I am talking about today. He just said incentives, and you all said you did not need them in 2005. It sure seems to be a different story today.

Mr. WATSON. First, we are not eligible for percentage depletion, which you cited. Second——

Senator WYDEN. You are eligible for a lot of incentives.

Mr. WATSON. You cited that conditions are exactly the same as 2005. They are not, respectfully. We have seen costs rise dramatically in our business. Any of a number of published indices would tell you that the cost of doing business has more than doubled in our industry since that time. We are not asking for special treatment, we are asking for the same treatment and comparable treatment to other industries, Senator.

Senator WYDEN. If you look at what the Congressional Research Service has even said, and they said that recently, you all continue to go way beyond inflation in terms of your costs. In fact, if you took inflation-adjusted prices today, the price of oil is higher than it was in 2005. That is, adjusting for inflation today.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Snowe?

Senator SNOWE. Thank you, Mr. Chairman. I welcome all of you here today. I felt like I was in a time warp when Senator Wyden was mentioning that hearing, because I was there as well back in 2005.

I think the greatest travesty to this country, frankly, is that we do not even have an energy policy. I do not know how many energy crises have to occur in more than a generation to prompt and compel a President and a Congress to develop a comprehensive energy policy. It has transcended many administrations and many Congresses, and it has eluded us; hence, what we are dealing with here today.

So we can have multiple hearings, but, if the hearings do not result in action and creating that policy, we have let down the American people. We should be examining all aspects and all facets of what we do, and that is the necessity of why we are having this hearing today. But we should examine all the subsidies and all the tax incentives that we provide in the tax code.

Frankly, we have put many of them on cruise control for so long. The challenge that we are facing today—and I hope, Mr. Chairman, you will have more hearings on all these other subsidies and tax incentives, because we have not looked at them in terms of their effectiveness. I think we need to have an energy policy. I think the President and the Congress ought to do it. That is what people are asking: why can we not get an energy policy? So I think that that is an abject failure, without question.

The real issue for us here today is to address the effectiveness of the tax incentives that are given to your industry, given that you obviously provide a very basic commodity to the American people. In my State, they pay, on average, $3,500 for oil and electricity, and another $1,660 for gasoline. American consumers right now are paying the third-highest consumer bills in 1 month, which was last month. So obviously we have to look at everything in terms of what we can do to mitigate those prices.

Now, back in 2005, oil per barrel was $65. Today it is, as you know, $100, $104, $110, it may be estimated. Oil has gone up, an 87-percent increase. Gasoline in 2005 was $3, now it is more than $4.

The question I had for all of you—there are two things. One is, what can you tell us that we can tell the American people, our constituents, how effective these benefits have been to your companies in helping to mitigate those prices, first of all?

Second, there was a report that was done by Wood and Mackenzie for the American Petroleum Institute last August. They talked about, in speculating about removing these tax incentives, how it would alter the break-even point for oil. That is the cost for profitability from an average of $47 per barrel to $52 per barrel. If oil is priced at points higher than $80, removal of these incentives will not result in any lost oil production. So I would like to have you comment on whether or not you agree with that. Is there a point at which we could remove these incentives, at a price point beyond $80 or beyond $100? I would like to have your response to that as well.

But first, what about the effectiveness of these? What can we tell the American people? How have they benefitted? Because that is what we have to examine, and that is what we should examine, by the way, on all tax incentives and breaks that are in the current tax code.

Mr. Watson?

Mr. WATSON. Senator, thank you. I understand some of the concerns. In California, we have very high gasoline prices, a high unemployment rate, and a lot of people are hurting these days, and they ask the same questions. I would tell you that the policies that we have had over the last decade have provided some benefit in terms of U.S. oil production.

Last year we did increase oil production because, over the last decade, we had opened up acreage to development, and we had had stable and predictable tax policies in place. What we have seen recently is that we have not conducted lease sales.

We have had a moratorium on drilling in this country, and we are contemplating tax increases that will only move production the other way. Some of the Wood Mackenzie studies that I have seen

indicate that the impact of a $5-billion increase on our industry would have a dramatic impact on production going forward. They have talked about reductions in production, domestic production, of some 400,000 barrels a day, with substantially more at risk. So that is the dilemma that I think we have when we think about increasing taxes on the producers in this business.

Senator SNOWE. Even in the context of record profits, it would still have an enormous impact on your industry?

Mr. WATSON. We make about 6 cents on sales, and we make about 6 cents a gallon in our gasoline business. If there is a big concern about gasoline prices, Federal and State governments make 50 cents a gallon. There is an opportunity to reduce prices significantly.

Senator SNOWE. Mr. Odum?

Mr. ODUM. Well, first of all, I could not agree with you more about needing a long-term energy policy, because I think ultimately we have to get to the fundamental issue here, which is something that has to be addressed over a period of decades, in my opinion. But you need a real strategy to execute to do that.

To go to the question, has the current tax structure helped investment, I think we are in a position today where the U.S. is competitive and it attracts investment. So to give you an example, we are growing our business in the U.S. We have made, on average over the last 5 years, about $3 billion a year in income from just the U.S. We have invested about $6 billion a year in capital projects for new energy projects. So I think that shows you that this is competitive.

The issue then, to address the more fundamental issue and to have the larger financial impact on the U.S., is to provide more access, bring more production online, and bring more revenues into the Federal Government. I can give you a very clear example, and then I will leave it to somebody else. But, if you look at offshore Alaska, the University of Alaska has done some studies there. Of course, it is an enormous resource potential. The estimated number of jobs associated with developing that resource is over 50,000 for a multi-decade period of time. The amount of revenue that would come from developing those resources is simply on the order of $200 billion to governments, to the U.S. State, local, and Federal Governments. So there is a real opportunity here, but we have to take a longer-term view.

Senator SNOWE. Thank you.

The CHAIRMAN. Thank you very much, Senator.

Senator SNOWE. Thank you.

The CHAIRMAN. Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman. Thank you all for coming. First, one of my colleagues suggested that this hearing is nothing more than a dog-and-pony show. Well, you would have an easier time convincing the American people that a unicorn just flew into this hearing room than that these big oil companies need taxpayer subsidies. That is the real fairy tale. I would just say to everybody, the average American family getting gouged at the gas pump across America and being asked to sacrifice because of the budget deficit certainly does not think this is a dog-and-pony show.

Now, I would like to just ask my colleagues here about the question of priorities, because we frankly sit in different seats than you do, and your job is to maximize what is good for your stockholders and good for your employees. I think we all understand that. But we have to choose priorities, and right now we have a huge budget deficit.

Many, particularly my colleagues who have put forward budgets on the other side of the aisle, have said that the budget deficit, even though we do not like it, says we should cut aid to students who need to go to college, we should cut cancer research, we should cut Homeland Security and veterans' funds. It boils down to priorities, because we have to get the deficit to a certain level, and we have choices. So I want to ask you, sitting in our shoes, just about your priorities. So my first question is to Mr. Mulva, and I am asking you for a reason. Do you think that your subsidy is more important than the financial aid we give to students to go to college? Could you answer that yes or no?

Mr. MULVA. Well, it is a very difficult question for me, two totally different questions.

Senator SCHUMER. But we have to weigh those two things, Mr. Mulva. We have to weigh it because we have to get the deficit down to a certain level. If you had a choice of one or the other as an American citizen, which would you choose?

Mr. MULVA. Well, Senator, that is a choice that, legislatively, you are going to have to be making.

Senator SCHUMER. We are.

Mr. MULVA. But for our company, what we are tasked with is to provide energy in an affordable way for the American public.

Senator SCHUMER. So you would choose the oil subsidy over aid to students. That is what you are telling me, which I think most Americans, even those who worked in the oil industry, would probably agree with.

I want to ask you one other question. This is why I asked you first. Your company put out a press release yesterday. Here is what the headline was: "ConocoPhillips Highlights Solid Results and Raises Concerns Over Un-American Tax Proposals at Annual Meeting of Shareholders." Do you think people who advocate cutting student aid, are they un-American, too?

Mr. MULVA. Well, Senator, in that media release——

Senator SCHUMER. Yes. What do you mean?

Mr. MULVA. Nothing was intended personally or anything like that. Quite contrary. Our release specifically refers to tax proposals and the subject matter that we are talking about here today.

Senator SCHUMER. Well, I want to ask you a specific question. Do you think anyone who advocates cutting these subsidies is un-American, yes or no?

Mr. MULVA. Well——

Senator SCHUMER. Yes or no, sir. That one, we deserve a yes or no answer on. It was your release that said "un-American." Yes or no.

Mr. MULVA. Senator, maybe you could hear me out on this because it is a very important question. So if just, if I could, would make a comment or two to respond to you.

Senator SCHUMER. Do you apologize for it?

Mr. MULVA. Make no mistake: were these proposals enacted that we are talking about today—which you say are subsidies, incentives, the proposals that the Senate is considering and the committee is considering—if they were enacted into law, they would place the U.S.-based oil companies and natural gas companies like our company, probably others——

Senator SCHUMER. Sir, I have limited time. I know your view on the issue. Do you consider it un-American to have a different view, yes or no?

Mr. MULVA. Senator, I believe that the proposals under consideration are going to have a very adverse impact with respect to energy policy——

Senator SCHUMER. I know. But there are many—sir, there are many people who disagree with that. You obviously have your point of view. That is why you are here. I am glad the chairman let you do it. But do any of you others consider it un-American to be against the subsidy that you are for? If you do, raise your hand. All right. Thank you. I appreciate the other four of you not labeling those who are different from you "un-American." Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Roberts?

Senator ROBERTS. It is very difficult to follow the unicorn from New York who has a very sharp horn. [To the witnesses]: Are you all right over there? [Laughter.]

Sometimes a unicorn can sort of morph into a rhinoceros, and you do not want to mess with a rhinoceros. At any rate, I am not making assertions there, Chuck—yet.

Mr. Tillerson, I met with a young man yesterday who was the manager of a small Exxon refinery—partly owned by CITGO, Hugo Chavez—in the mountain west region of the U.S., who was seriously concerned about his job security and the job security of his 250 other employees working at his refinery because of the legislation seeking to repeal section 199. I note that, because his refinery is partially owned by CITGO, that repeal of this tax expenditure would not affect Hugo Chavez's interest, but would his.

Now, I would call that sort of un-American. Sorry, Chuck. But why on earth would we be taxing a U.S. company and this young man very worried about his future and then letting big Hugo do his thing in Latin America, or Central America? There might be some confusion, I think, when some of my friends claim that removing these tax expenditures will not have any impact on the domestic oil industry.

So why would this young man, Mr. Tillerson, think differently? Has the refining sector not seen as much profitability as the oil exploration and production sector? Are the jobs really at risk if these taxes are revoked?

Mr. TILLERSON. Well, if you look at our own refining operations, refining has lost money 5 of the last 8 quarters. We made some money in the first quarter, we lost money in the fourth quarter. It gets back to, what is the price of gasoline? What is in that? It is fundamentally the cost of the crude oil that the refiner has to acquire. We are one of the largest refiners in the world. We produce

about 2.5 million barrels a day of crude oil. We refine 5 million barrels a day of crude oil.

So we are in the market having to purchase 2.5 to 3 million barrels a day of crude oil, every day, to feed our refineries. So when the cost of the oil is high, the refineries' margin gets squeezed. They are unable to pass that through to the finished products fully. So the refiners do struggle with very thin margins, so, when you increase the tax burden on the refiner, you erode his margin. When you lose money 5 out of 8 quarters, obviously it is pretty skinny already.

Senator ROBERTS. I appreciate your answer.

Mr. Chairman, it was my marching orders now, I understand, to present the statement by Senator Cornyn, and I have a minute and 37 that I am going to yield back. I would like permission to express Mr. Cornyn's statement at this point, if that would be permissible. I do not want to tread on anybody's time over there, or whatever.

The CHAIRMAN. Go ahead. You have some time; let us use it.

Senator ROBERTS. All right. Well, I am going to skip the thank-yous to you and to Ranking Member Hatch, although I certainly want to thank you, and so does Senator Cornyn. Obviously I am not Senator Cornyn. I do not even look like him.

But at any rate, he goes into how important this issue is, how a multitude of variables impact on the cost of gasoline, and that we should not overlook the main factor that impacts the prices at the pump. That is what Senator Hatch said—I am skipping here. With roughly 70 percent of the price of gasoline and diesel contingent on the price of crude, it is easy to understand any fluctuations in global supply and demand if crude is the most important factor in what the consumer pays for at the pump.

And he goes into the fact that we are overly reliant on foreign countries, and understanding again that this commodity is traded on a global scale. And increased production cannot serve as an immediate magic bullet for solving rising gas prices, but it is a strong start.

He supports the domestic exploration and drilling. And to fight against our almost 9-percent national unemployment rate, why then would we pursue any policy as counter to this type of job creation? He indicates that the proposals—we will now call them the unicorn proposals—by some of my colleagues in the Congress and by our own President would be counterproductive. Then he has a video. I am not a chart man, I am not a video man, but I am now Senator Cornyn, and so we have a video, and I would like to have somebody play it.

The CHAIRMAN. Senator, you have gone over 20, 30 seconds already. How long is this video?

Senator ROBERTS. Well, it is 2 minutes. See, I had 5 minutes, and now I am Senator Cornyn, so now I have 10 minutes.

The CHAIRMAN. You are one Senator. There is no one—you are the incomparable Senator Roberts. There is no other Senator——

Senator ROBERTS. I appreciate that. We were not joined at the hip; we were separated. But if we could play this thing, then I am going to be in a lot better shape with my colleagues. It is only 30 seconds. I am sorry. We just cut it down from 2 minutes to 30 seconds.

The CHAIRMAN. All right. Thirty seconds.
Senator ROBERTS. Thirty seconds. Here we go.
[Whereupon, the video was played.]
Senator ROBERTS. See? That was 30 seconds. A little over a week ago, the President called for reducing foreign imports by a third. There is a serious disconnect. That is the comment by Senator Cornyn, and I truly appreciate your lenience and your treatment of this poor minority member.
Thank you, sir.
The CHAIRMAN. Thank you, Senator.
Senator Cantwell?
Senator CANTWELL. Thank you, Mr. Chairman. Thank you, gentlemen, for being here today. I know the subject of this hearing is about tax subsidies and the effect on the deficit, but I would also like to get your opinion about this issue, obviously, on the price of oil today, because many Americans are definitely feeling the impact at the pump. Mr. Odum's testimony talked about how oil is a global commodity and that oil companies are price takers, not price makers. I am assuming generally people agree with that statement that Mr. Odum had in his testimony?
[Nods in the affirmative.]
Senator CANTWELL. Thank you. What role do you think excessive speculation in the futures market is having on elevated oil prices? I know that some of your colleagues—I think, Mr. Tillerson, in the past you talked about speculation and the weakening dollar having more of an effect than supply and demand, so could you comment about speculation, excessive speculation in the market and what effect you think it is having on today's prices?
Mr. TILLERSON. Well, it is very difficult to precisely say what impact it has. It is also very difficult to separate in the marketplace speculation and risk management because the two are actually quite intertwined in terms of how people manage the risk of the price of the fuel, whether they are a consumer or a producer.
I would give you just one benchmark. Immediately after the Libyan outbreak, the fighting in Libya, within the next day the price of oil went up $12. Now, nothing had changed in the global supply the next day, so what was the market reacting to? It was reacting to some level of insecurity about what the future supply was going to be.
So that is people pricing in to the global market what they believe their cost is going to be sometime in the future, building in their concerns and their worries about other possible supply disruptions and the ability of the market to respond to that. As time goes by and people see how the market responds, they need to adjust back. It goes up and down.
Senator CANTWELL. What do you think the price would be today if it was based on fundamentals of just supply and demand?
Mr. TILLERSON. Well, again, if you were to use a pure economic approach, the economists would say it would be set at the price to develop the next marginal barrel.
Senator CANTWELL. What do you think that would be today?
Mr. TILLERSON. Well, it is pretty hard to judge. When we look at it, it is going to be somewhere in the $60 to $70 range. If you said, if I had access—that is the assumption—to the next marginal

barrel, what would it cost, everything in, to put the next barrel of supply in there, as soon as I develop that one and it depletes, then for the next barrel, marginal cost goes up.

Now, over the years the industry has historically done a very, I think, successful job of mitigating that through technology advancements, efficiencies, things we learn how to do better to keep the cost of the marginal barrel down. But in a purely economic—if all things were according to economics and people did not risk-manage and they did not do everything else they do, it would be set at the marginal cost of the next increment of supply.

Senator CANTWELL. So, $60 to $70 a barrel sounds pretty good today, I can tell you that.

Mr. TILLERSON. Then when we produce that barrel it will be, what does the next barrel cost?

Senator CANTWELL. I mean, oil dropped 5.5 percent yesterday. Last week, it was 8.6. I do not think that has to do with the dollar, Mr. Odum, or weather. I think that has to do with a lot happening and the volatility of the market. I am curious as to what you think we should be doing about that volatility. Mr. Odum, do you have any comments?

Mr. ODUM. Yes. Some of the factors that I mentioned are clearly factors. Now, neither one may be dominant in the current day or the current week that we are talking about, but all of those are very real factors on the price.

I think on the topic of trading, though—I am anything but a trading expert, but I do know it has been studied many, many times by the Commodities Futures Trading Commission and others to try to understand some of the questions you are asking about, what is the increase in price that could be associated with that. I do know that it serves a very important function. Whether it is an airline trying to have predictability around its fuel cost for the future and so forth, it does serve a very important function.

Senator CANTWELL. Well, I would just say this, that with 70 percent of that futures market now being made up of speculators who are not the end users of that oil product is a problem. To go from having the market made up of 30 percent today of people who legitimately have to hedge dominated by 70 percent of people who are just getting, obviously, in on this oil game, is a problem. Do you agree, or do you think that it is all right to have the market drive up your price, and then you come here to talk about these subsidies as an end result? Mr. Tillerson, I see you smiling. Do you have any comment about that?

Mr. TILLERSON. Well, we are not traders ourselves, so we are not in that part of the market. We are observers. That is why I say we are price takers. We are physical buyers and sellers of barrels. The market decides, again, as I said, based on their view. It is really a view of the future because it is a depleting resource: what is going to be the availability of the oil sometime in the future?

The market tries to decide that based on a whole range of things it worries about, and then it translates that back to a price today, and that is the price we take. It will just be wherever it will be. It has been at $9 a barrel, it has been at $8 a barrel during my career, and it has been at $147 a barrel, and that is the nature of

a commodity. It is the nature, in this case, of a very volatile commodity.

Senator CANTWELL. I disagree. I do not think that is the nature of how the commodity markets were established. The commodity markets were established to basically prevent or to basically lessen the risk that individual users have to take. Now, with 70 percent of the market being driven by speculators who are not the end takers of any product, I think you are seeing this price driven up way in excess of the $60 to $70 a barrel that you say would be supply and demand.

So, thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Menendez?

Senator MENENDEZ. Well, thank you, Mr. Chairman. First of all, let me say I really appreciate Senator Hatch spending so much time on the research he has done on New Jersey, although I take offense to, in his opening statement, the aspersions cast on New Jersey, even if they are ascribed to some comedian.

The fact of the matter is, what we have is a lot of hardworking New Jerseyians who are being hit really hard at the pump and at the same time are subsidizing these Big 5 oil companies, so I am sure my colleague from Utah will be happy to tell his taxpayers why he supports that.

I agree about the dog-and-pony show. I would not hold my breath waiting for Republicans to say to our friends in the oil industry, you have to be part of shared sacrifice in reducing the deficit of this country when the average American is making a median income of $50,000 and these companies, on average, are making about $25 billion projected this year. Somehow, only in Washington would eliminating those corporate subsidizes be a tax increase, so I am glad I did not hold my breath for that.

I want to, first, ask Mr. Mulva a question. Yesterday in a press release, your company called proposals to eliminate wasteful oil subsidies "un-American." I want to hear from you, do you make those accusations lightly, or did you really mean to question my patriotism and the patriotism of the 28 other U.S. Senators who are co-sponsors? Do you believe that President Obama is un-American because he has proposed cutting oil subsidies? Do you believe that former President Bush, Speaker Boehner, and Congressman Ryan are un-American because they have expressed cutting oil subsidies?

Mr. MULVA. Senator, it was the media title of our media release. Nothing was intended to be personally directed to you, any of the Senators, colleagues, or anyone. It was merely utilized because we felt the tax proposals that are under consideration are inconsistent with the treatment of all taxpayers in a similar situation. It seems unfair to highlight, or in a discriminatory way, select five different companies for different tax treatment.

Senator MENENDEZ. But if you believe, at the end of the day, that those proposals—which I can understand you might disagree with. But you classify them as "un-American." That means those who promote them are un-American. I think that is beyond the pale. That is beyond the pale. I was hoping you were going to come here and apologize for that because it is simply beyond the pale. So are you willing to apologize for what your company——

Mr. MULVA. Senator, as I just said, there is nothing intended personally. What it was is, we felt that——

Senator MENENDEZ. So you are not willing to apologize?

Mr. MULVA [continuing]. The tax proposals under consideration were a question of fairness. The other was that the tax proposals under consideration are inconsistent, without having an energy policy that would have an adverse impact on——

Senator MENENDEZ. The bottom line is, you are unwilling to apologize for your company's statement. All right. So I will continue to take offense to it.

Last year, ConocoPhillips spent nearly $4 billion buying back its own stock, which of course helps raise stock prices and enriches investors in the company like yourself. It seems to me if subsidies were cut, could you not simply buy back less stock and make consumers whole?

Mr. MULVA. Senator, our share repurchase that we have announced is in the neighborhood of about $10 billion, and it essentially equates to the sale of our 20-percent interest in a Russian oil company called Lukoil. We felt the opportunities for investment in Russia were not that great, being opportunities of essentially owning shares in a Russian oil company. We are better treated by owning our own shares. It had nothing to do with respect to our capability for investment for energy opportunities or for paying dividends to our shareholders.

Senator MENENDEZ. But you took those profits. You had a lot of decisions as to how you would take those profits, and you put them in the whole stock repurchase.

Let me ask Mr. Tillerson: I have heard a vigorous defense of preserving tax rules that allow oil companies to disguise foreign royalty payments as foreign tax payments and therefore get a U.S. foreign tax credit. Now, why should taxpayers in the United States be subsidizing your drilling in Indonesia where royalty payments are hidden as a 44-percent tax on oil companies? Why should U.S. taxpayers be, in essence, subsidizing the foreign production of oil?

Mr. TILLERSON. They are not.

Senator MENENDEZ. How are they not, when in fact those are royalty payments?

Mr. TILLERSON. They are legitimate income taxes paid to the government of Indonesia. As I said in my statement, one of the ways our industry is treated differently under a foreign tax code than ours is, we must prove that these are income tax payments and not royalty payments. So the Internal Revenue Service—we house 35 auditors 365 days a year in our offices—looks at those very thoroughly, and we must prove to them that in fact they represent income taxes and not royalties.

Senator MENENDEZ. Well clearly, if you pay, as a structure, taxes to a foreign country, the IRS does not have a lot of opportunity to dispute that. But if in fact you devise your agreements in such a way to have the payment of royalties be a tax, you get a deduction here in the United States. That simply means U.S. taxpayers are subsidizing.

I find it hard, gentlemen—I see my time is up. But I find it hard to understand how you can come here before this committee and the American people and say, when you are projected to make

$125 billion in profits this year, that you simply cannot—and the marketplace is driving you to exploration and production; you really do not need this to pursue production and exploration—that somehow the loss of $2 billion a year, which means you would only make $123 billion in profits, is somehow so punishing, somehow not part of shared sacrifice, somehow you need to go back at them at the pump to make up for it, is hard to understand. It is hard to understand.

I really thought you would come here with a different view, like when the auto industry came here with a different context. They came with a different view. You are really surprising to me. Mr. Mulva, I am shocked that you are not willing to acknowledge that your company's statement that this is "un-American" is ultimately casting an aspersion upon all of us who have a different point of view here.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Cardin?

Senator CARDIN. Thank you, Mr. Chairman.

I thank all five of our witnesses for being here today. I want to make an observation first in regards to some of the points Senator Hatch made. I think the best thing we could do to strengthen pension plans in this country is a growing, strong economy with stable energy prices. I do not think the profits of the five big oil companies have much to do with the stability of the pension systems. I just had one other observation, the point that Senator Menendez made.

I listened to your responses, and the math is so overwhelming, with five companies that are making in excess of $100 billion a year. I do not want to say that $4 billion, which is I think the number of these tax issues, is insignificant, but it is certainly a very small amount of money. Whereas, $4 billion is a huge amount of money in regards to the decisions that we have to make here on priorities with our children, our seniors, or America's growth.

I just think we have to put this in the proper context. We have to make some tough decisions. It seems to me this is one area that we should be able to reach some common understanding on, and I would just urge you to understand the difficulties of our economy on balancing our budget and the long-term impact of this deficit. We are all going to have to make sacrifices in that regard. It seems to me that five companies that make over $100 billion, that there is a reason why we are looking at this.

I want to go to a bipartisan issue, one which Senator Lugar and I have championed. That deals with the issue, Mr. Odum, that you mentioned on stability of the supply of oil globally. That is the deal with good governance and transparency. In so many countries that have mineral wealth, the countries are incredibly poor as far as the living conditions of the people in that country. The reason is that the mineral wealth never gets to the people; it is used in many cases to finance a corrupt system, leading to instability, as we have seen in recent months. When you have autocratic systems that are not transparent, the people ultimately will stand up to them.

But in the meantime, we have an unstable supply, causing investors to be very nervous about putting money into those countries. So Senator Lugar and I have been working for some time to sup-

port first the extractive industries' transparency initiative, which works in some countries, but many of the oil-rich countries of the world do not participate in the extractive industries. Therefore, we were successful in getting, as part of the Dodd-Frank legislation, disclosure to be made with the SEC as it relates to payments paid by oil and gas companies to other countries so that we could have more transparency and better good governance in these countries.

The industry at times has been helpful to us on transparency. For reasons I do not understand, there seems to be a reluctance as it relates to this most recent change. This applies not to U.S. companies, it applies to all companies that have to move on the SEC. The news, quite frankly, is that we have friends in Europe, Canada, and other countries who want to see this made worldwide on all the exchanges so that all companies will, as a matter of good governance, have to disclose these payments.

There was a time when bribes paid to other countries for business were a way of life, but we stood up to that and said "no" to that type of practice because we knew that this was not in the U.S.'s long-term interest. I would just urge you—and I would like to get your response—to work with us so that we can get more stable countries around the world, which is in our interest as well as the people who live in those countries. We need your help. I just am curious as to why we seem to be at odds on this issue. I would hope that you would not only comply with the spirit of the bill that was passed in Congress, but help us make sure this is implemented in a fair way to accomplish its results.

Mr. Odum, you mentioned stability, so that is the reason why I directed the question, at least first, to you.

Mr. ODUM. Well, no. I appreciate your comment, Senator. I think it is pretty clear. I think with our interchange between our company and yourself and others, that we support the intent of transparency. We actually work quite hard for transparency around the world through various initiatives.

I think some of the constructive and pretty comprehensive input that we try to give is that we need to do that in a way that does not force these companies into an uncompetitive situation, that recognizes some of the challenges that we have with the foreign governments in terms of enforcing something that may actually be illegal in these countries and sorting out that balance. So there are complications associated with it. We support the intent and are trying to work with you on how to get to the right answer.

Senator CARDIN. The standard contracts that deal with it have exclusions for SEC-required filings, so it seems to me that the point that you raised that you would be in conflict with the host country is not what is in the standard contracts that you deal with.

Mr. WATSON. Senator, if I could just perhaps offer a couple of comments on this item. We, too, have been very active in the Extractive Industries Transparency Initiative. We have a comprehensive human rights policy, and frankly agree with the objectives of what you are describing. Forcing U.S. registrants to disclose the voluminous information that is required under the law not only is onerous but puts us at a competitive disadvantage to those that do not have to comply with the law. It is a very one-sided law at this point.

Senator CARDIN. Work with us so that everyone has to comply with it. That is what we want to do. We have friends in Europe, friends in Canada, friends around the world who want to work with us to make sure this is a uniform policy.

Mr. WATSON. If you can find a way to have Russian, Chinese, Indian, and other companies comply with the law so that everyone is forced to comply, that might be a different story.

Senator CARDIN. With you on my side, I can get there.

The CHAIRMAN. Thank you, Senator.

Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman.

It has been interesting to just observe the hearing, the polemic that started it out and then the five of you. Mr. Tillerson, you are doing very good things with the Boy Scouts. It affects my State of West Virginia. I can thank you for that, but I cannot thank you for a lot of other things.

I get the feeling that it is almost like the five of you are like Saudi Arabia, that you are caught up in your profits, you are highly defensive, you yield on nothing. The concept of sharing, in what you have said, almost means that you would have to move to another country, which I do not accept because you are already in all kinds of other countries, and you are all over the world, all of you. I guess most of you. I do not know that all of you are. But being out of touch not only with what we are going through in terms of Chuck Schumer's questions, but with the American people. I do not think I could blame you for that.

I think I can just observe that the nature of your life, the nature of your international travel, the nature of the size of your profits—I do not think you have any idea of what the size of your profits does to the American people's willingness to accept what you have to say, which is basically, anything you do to increase our cost is going to force us to go overseas, which I do not accept. I mean, I think you are saying that. You would get away with it, I cannot prove you wrong, but I do not believe you.

So I just want that on the record. I think you are really out of touch. We are making, in these budget decisions—the Ryan budget would cut the U.S. Government in half. In half. People dollars. All kinds of things would just stop happening.

Now, I come from West Virginia, and I care a lot about Medicaid, I care a lot about education, about Head Start, about the National Cancer Institute, about NIH. All kinds of things that are going to take enormous hits while you are not.

My guess is that you will be able to protect yourselves, because traditionally oil companies have been able to, through their lobbyists and through friendships and through placements of refineries in so many Senators' States, et cetera, you are able to prevail. You are accustomed to prevailing.

You assume you are going to prevail, which is part of what I think creates the distance between us and you, and perhaps between you and the problems that this country faces. I do not know how serious you are about those problems. I mean, we are kind of terrified up here. I mean, we had a meeting with the President yesterday, and the sizes of the cuts were awful. I mean, it means people lose their health insurance, it means all kinds of things. All

kinds of things just stop happening, not in what he suggested, but in the scenario that possibly could come out of this budget-cutting atmosphere.

So let me just stipulate that. I think you are out of touch, deeply, profoundly out of touch and deeply and profoundly committed to sharing nothing, because, if you share something, you get on the slippery slope. If you give up something, you are on the slippery slope. If you give up something, then how do you explain that to your stockholders, and all the rest of it?

Let me ask you just two questions. Senator Wyden made very well the point about the $55 a barrel, and now you are at $102 a barrel and talk about having to move overseas, et cetera. How much profit on a barrel of oil do you have to make to not be needful of these subsidies that we think you do not need, but you say your life depends on? At some point you would not need the subsidies. I think you are there already, but you do not. So at what point do you think that you do not need these subsidies?

Mr. WATSON. As we have described, we do not receive subsidies, Senator. What we do require is a reasonable return on our invested capital. I would tell you that I do not think the American people want shared sacrifice, I think they want shared prosperity. What we have to offer, Senator——

Senator ROCKEFELLER. A lovely statement. But do you understand how out of touch that is? We do not get to shared prosperity until we get to shared sacrifice.

Mr. WATSON. More oil field workers are unable to work today because we cannot receive drilling permits or there are leases that are not being made available. They feel that.

Senator ROCKEFELLER. What about the fact that, in the case of Exxon Mobil, that your effective Federal tax rate is substantially 3 percent lower than what the average individual Federal tax rate is? Does that mean anything to you?

Mr. TILLERSON. Well, first, Senator, I want to assure you I am not out of touch at all. We do understand the big picture, and we understand the enormous challenges confronting the American people with respect to this enormous deficit that has to be dealt with. Often it has to be dealt with in a very large way. So I just want to acknowledge that we are well-aware of that fact.

Senator ROCKEFELLER. So what do you want to——

Mr. TILLERSON. My effective United States income tax rate on my United States income from 2005 to 2010 was 32 percent. Now, if you look at any individual year, it could be as low as a single digit, it can be as high as 38 to 39 percent, because we do not settle our taxes for that year in that year. We have tax filings that are open for multiple years. As we resolve issues with the IRS, they are recognized in the year we file. So in some years, when our taxes appear low, it is because we have recognized the closing of issues with the IRS where we overpaid.

Senator ROCKEFELLER. And I understand. But still, do you understand the average American's feeling that between 2008 and 2010, your effective tax rate was about 17 percent and theirs was about 20 percent?

Mr. TILLERSON. From 2005 to 2010, our effective tax rate was right at 32 percent.

Senator ROCKEFELLER. Yes. Well, then that leads me to the next round of questions, if we have those.

The CHAIRMAN. Thank you, Senator.

Next, Senator Stabenow.

Senator STABENOW. Thank you very much, Mr. Chairman.

We appreciate all of you coming here.

This really is about our priorities as a country. In a time of tremendous challenges and deficits, we have a responsibility to review everything. Taxpayers are expecting us to ask tough questions and determine priorities and look at what is needed, not needed, works, does not work. That is our job. When we look at the fact that it was 1916 when one of these tax subsidies that we are talking about repealing was put into place—the deduction for intangible drilling and development costs—crude oil was roughly $15 to $17 a barrel at that time.

I am sure you would agree things have changed since then. It is very appropriate to look at whether or not, when we were developing then and creating the industrial revolution—which we are very proud to have led in Michigan—whether or not now when you fast forward and it is not $17, it is $100 or more, and you are in a very different position in terms of success and corporate profits, does it make sense for taxpayers to subsidize what you are doing? Not that we do not want you to be successful.

Does it make sense for taxpayers to subsidize what you are doing? Essentially, folks in Michigan feel like they are getting hit twice. They are paying the high price at the pump—there is not enough competition and consumer choice where they can choose not to pay your prices—and at the same time they are turning around and paying out of pocket as well. So people are extremely concerned when we have to make choices about whether or not these subsidies are working right now.

So the question that I would have—when we look at the last 3 months and the corporate profits together that all of you have made, the highest corporate profits I think ever, and the fact that the taxpayer subsidies are 1 to 2 percent of that profit—that is the reality. It is 1 to 2 percent of all of your profits. You are now saying that, in light of massive deficits, and you have massive profits, that taxpayers should keep providing 1 to 2 percent of your profits or you are going to raise gas prices again.

So my question is the opposite, and I would like each of you to answer. What would it take, in lieu of taxpayer subsidies, for you to bring our gas prices down? Mr. Tillerson?

Mr. TILLERSON. Well, first, it is not a subsidy, it is a legitimate tax deduction. I think, again, the important question is, what is necessary to develop additional supply in this country?

Senator STABENOW. But what would it take? It is 1 to 2 percent right now.

Mr. TILLERSON. And those——

Senator STABENOW. So what does it take? What do we have to pay you to bring prices down?

Mr. TILLERSON. The intangible drilling cost structure is structured to incentivize and help people go out and invest in the next incremental barrel of supply. In this country, today that is largely coming from the shale resources in the Bakken Formation.

Senator STABENOW. I appreciate that. But in the interest of time, I am going to ask——

Mr. TILLERSON. Well, and I am trying to answer your question. So, if you do not want the incremental supply, you make the tax structure higher, and the incremental barrel does not get developed. It is as simple as that.

Senator STABENOW. So the 1 to 2 percent that we are talking about, which is a big deal for taxpayers, by the way. When we are looking at colleagues on the other side of the aisle wanting to eliminate Medicare as we know it, and we have to make choices here—which by the way I am certainly not going to support that—the question is, what is effective? What works?

It is really not credible to say that you are going to raise gas prices simply because we are asking you to forego 1 to 2 percent of your profits, if you are saying that. You are going to raise our prices, and right now there is not enough competition. We are held hostage. There is not enough competition for us to be able to deal with that.

So, if we take away 1 to 2 percent of your profits, you are saying that that will cause you to raise our prices again. My question is, what will get you to lower them in terms of the subsidy? If taking away 1 to 2 percent will cause you to raise prices, do we give you 4 percent? Five percent? How much more do we have to give you?

Mr. TILLERSON. We did not—I did not say we would be raising gas prices at the pump. I did not really hear anyone else say that either.

Senator STABENOW. I certainly——

Mr. TILLERSON. It really is——

Senator STABENOW. There is a real threat here.

Mr. TILLERSON. It really is about, do we want to solve the problem by getting some more supply developed, which also in this country will generate additional revenues for the Federal Government and will relieve the price pressure in the years to come. That is the role that the tax structure plays.

Senator STABENOW. Mr. Tillerson, I understand that.

Mr. TILLERSON. If you want to eliminate the tax incentives——

Senator STABENOW. Before my time runs out——

Mr. TILLERSON [continuing]. The incremental barrel does not get developed.

Senator STABENOW. I appreciate that, and I am not being disrespectful. But let me just say, we have to decide, where is the most effective place to invest taxpayer dollars that are very hard to come by right now? People in my State want us to stretch every single dollar and look for what is the most effective and needed support and subsidy. So just very quickly, Mr. Mulva, how much do we have to give you in additional tax subsidies in order to bring prices down?

Mr. MULVA. Senator, we are not asking for tax subsidies or incentives. What we are asking for is access. Put our people back to work with the opportunity to start drilling onshore and offshore. By drilling, more drilling, we will create jobs, and we will create more supply. That is the best thing we can do to moderate prices.

Senator STABENOW. I appreciate that, and we are hoping that, in more of those 60 million acres that you have in lease, that you will be able to do that as well.

Mr. McKay? I am sorry, Mr. Chairman. I know I am out of time. I do not know if I might just ask them to——

The CHAIRMAN. If the answer could be very brief.

Senator STABENOW. Thank you very much.

Mr. MCKAY. I would just say, we are not asking for subsidies. Any increase in taxes will not be consistent with increasing investment for additional supply.

Senator STABENOW. All right.

The CHAIRMAN. Thank you, Senator.

Mr. ODUM. The current U.S. tax structure——

The CHAIRMAN. I am sorry.

Mr. ODUM. Fifteen seconds.

The CHAIRMAN. Fifteen. That is it.

Mr. ODUM. The current U.S. tax structure is globally competitive, which is why investment gets driven to the U.S. That is a good thing. Changing that would drive investment away. That is a fact. If I could leave one point with the entire committee today, it is simply to look at the enormous opportunity the U.S. has to develop these resources, to create the jobs, and to create the additional revenue into the Federal Government which will help with the long-term deficit issue. That is the real opportunity.

The CHAIRMAN. Senator Nelson?

Senator NELSON. Good morning, gentlemen. The American consumer naturally is quite concerned when they go to the pump and they pump gas. What they are concerned about is, they see the price of the barrel of oil going up and they see the price of the gallon of gas that they are pumping go up, and then when that price of the barrel of oil starts coming down, they do not see the commensurate lowering quickly of that price that they are paying per gallon at the pump.

So they noticed that, back in 2008, the price shot up to $147 a barrel, and, while they were pumping gas, it raised it to $4 a gallon. Now they see the price at around $100 a barrel, and they are still paying $4 at the pump. So I want to ask that question on behalf of the American people who are pumping gas in their cars.

Mr. TILLERSON. Well, it is a question of a supply chain. The average time for crude oil produced overseas to reach American refineries is somewhere between 30 days and 45 days. That is the transit time. You have oil that is in inventory at the refinery which has already been bought and paid for at some price. You have gasoline and products that are in inventory that have already been bought and paid for at some price, and often they are delivered to your local service station where the consumer pulls up to the pump and buys it. So when the price changes on that raw material of crude oil, that price has to make its way through that whole supply chain.

Now, when the price is going up, the retailer who owns the station and operates on a very, very thin cash flow—and the vast majority of service stations are not owned by us, they are owned by individual business owners or distributors—has to think about, what is going to happen to my cash flow as this price moves

through? So they do begin to price up in advance of the actual higher cost barrels getting to them in order to ensure they have sufficient cash flow to buy the next tanker wagon that has to deliver.

So that is why going up, as most business people would do, they worry about their cash flow. They are going to chase it a little faster on the way up. Coming down, they have to recover the cost of what they have already spent on the barrels in inventory. So, until those actual barrels make their way through the system to the pump, the consumer is not going to see it. Typically that may take somewhere between 2 to 3 weeks, depending on how big the movement is.

Senator NELSON. All right. I anticipated that that would be the answer, and I appreciate that. But the person who is pumping the gas is saying, wait a minute. Today I am paying 4 bucks for a gallon of gas, and oil is selling at $100 a barrel. But 3 years ago I was paying $4 for a gallon of gas, and oil was selling at $147 a barrel. Why?

Mr. TILLERSON. Well, the $147 price did not last very long. You remember what happened shortly after: it plummeted to the 30s. That is the nature—and we talked about this earlier—of this commodity which has an extreme amount of volatility in it. Why it moves in that wide a range, we could have an entire hearing on that subject.

Senator NELSON. And I would say that a part of it is the speculation that adds to that of people who do not use the oil. But, Mr. McKay, let me register a difference of opinion with BP. You all, in your financial report in the fourth quarter of last year, announced that the Gulf oil spill response costs were going to be approximately $41 billion and that you reported a tax credit of almost $12 billion.

Now, for activities that cause such harm, does it not seem wrong that you would take a tax credit, lessening your taxes dollar for dollar, on the payments that you are paying out to make people's lives right?

Mr. MCKAY. Let me first just comment that we have pledged all along to meet every commitment under the law with the accident and the economic impacts of the accident. The $41 billion is a financial charge. We did not take a $12 billion credit. We will be following the law, following the tax code in terms of writing off standard business expenses as they occur, as they are disbursed.

Senator NELSON. So you consider these as standard business expenses that you think that morally you are entitled to take as a tax credit?

Mr. MCKAY. The ones that are under the tax code as standard business expenses, yes. We will not write off things that are not under the standard business expenses.

Senator NELSON. You know, it is interesting that the Boeing Company, when they had those kind of payments, they did not take them as a tax credit. Also, with Goldman Sachs, the same thing. They did not because of the sensitivity of the wrongdoing that occurred. Surely the Gulf oil spill was as a result of wrongdoing, and yet you want to claim that as a tax credit.

Now, I just want you to know that I respectfully disagree with your position, and I would urge the chairman and the ranking member to consider—as BP may be entitled to this under the law, but that does not make it right—I would ask respectfully to the chairman that we consider changing the law to follow the example set by Boeing and Goldman Sachs.

The CHAIRMAN. Well, Senator, we certainly will consider it. We will consider any request made by any Senator, especially the Senator from Florida. Were you finished with your questions? Yes.

Next is Senator Carper.

Senator CARPER. Yes. Thanks very much. Gentlemen, thank you for joining us today.

About a month ago, sitting right in the middle there, was Alan Blinder, who used to be the vice chairman of the Federal Reserve. He was on a panel, a 3- or 4-person panel, and we were talking about deficit reduction, and asking a group of really smart people what they thought we ought to be doing.

I think it was Alan Blinder who said the 800-pound gorilla in the room on deficit reduction is health care costs. We live in a country where we spend about twice as much as they do in Japan and get worse results. They cover everybody, we do not. He said that is the 800-pound gorilla in the room.

I followed up his comment by saying, well, with respect to health care cost containment and getting a better result for less money, what is your advice? He said, "I do not really know much about that." He said, "But as a lay person, I would just say this: find out what works and do more of that." That is what he said: "Find out what works and do more of that."

Democratic Senators were over at the White House yesterday with the President, and our Republican friends were over there today. We had a conversation with the President about deficit reduction. I shared with him Alan Blinder's comments, which I think are not only appropriate for health care, but really for the way we spend money throughout the government.

My own view is, and I shared this with Alan Blinder that day, we need to look in every nook and cranny of the Federal Government, all of our domestic programs, our defense programs, our entitlement programs, tax expenditures, and just ask this question: is there a way we can get better results for less money or better results for maybe the same amount of money? We just need to change our culture in government, to focus on moving from a culture of spendthrift to a culture of thrift.

When it comes to tax expenditures, we need to do the same thing. There are assertions and a strong belief in this country, and certainly here today, that some of the tax expenditures that relate to your industry do not necessarily get us the best result for the amount of money that has been lost to the Treasury. We are going to vote on the legislation, I think, authored by Senator Menendez probably next week.

My guess is, there are not 60 votes to pass it. But later this year we are going to be voting on an effort to try to turn the deficit by about $4 trillion over the next 10 years and we are going to do that largely on the spending side, maybe $2 of spending for every dollar

of revenue. Entitlements will be on the table, domestic spending, defense spending, and tax expenditures will be on the table.

I would just say to you that, when the vote occurs next week and we do not get 60 votes for Senator Menendez's proposal, that should not be the end of this conversation. We should continue to have a conversation so that we can try to figure out, how do we get a better result for less money, or really, how do we get a better bang for the taxpayers' dollars. Your industry needs to be involved in that as well.

If I ran your business—and I do not pretend to understand it especially well—I would not consider myself an oil company. I would consider myself an energy company. My belief is, that is what you do. Most of you do that. I would just like for you to talk to us about the efforts that you undertake in your companies to move us away from fossil fuels, to move us toward sources of energy that impair health less than oil does, or fossil fuels do, that enable us to come up with new technologies that we can sell—manufacture products and sell them around the world.

Let us just go down the list. Do you want to go first and just tell us what you are doing to help us, through your company's efforts to develop renewables, non-polluting forms of energy, and what can we do to help you there?

Mr. TILLERSON. Well, Senator, first, I agree wholeheartedly with your comments on the deficit. Ultimately, we are an advocate for comprehensive tax reform. All of these things we are talking about today should be on the table in comprehensive tax reform.

As to what we are doing in developing alternative fuels—and we have concentrated principally on transportation fuels because that is what we know the best; we are not an electric power generator, so we are not into windmills, we are not into solar. It is just not our business. But we are in the transportation fuels business.

As we have evaluated all the various technologies available out there for alternative transportation fuels, the one that we believe has the most promise—although it is many years away—is to capture biofuels from algaes, from various strains of algaes. We have undertaken a joint venture initiative. We have committed $600 million with a company called Synthetics Genomics. They have considerable expertise in mapping genomes.

Ultimately, we think we are going to have to synthesize the type of algaes that are necessary to be able to scale up. First, we have to be able to take this to scale, and it has to be delivered at a cost that the consumer can afford. So we think there is a lot of promise in the algae space, but it is a long, long road ahead of us.

Senator CARPER. Thank you.

Please?

Mr. MULVA. Thank you. We continue to ramp up our spending on research and development for alternatives, and we similarly have a program that stresses algae. I would say, though, that fossil fuels represent, and will continue to represent, more than 80 percent of the energy that is required around the world.

One of the key things that is very important for our country is natural gas. It has been over the last several years. With technology developments—and we are blessed with a great deal of natural gas, some think for decades, and some think even for centuries

to come. So we are really applying a lot of research and development, how we can develop natural gas even cleaner and more efficiently. We think our country is robust with these resources for standard of living and development of our economy.

Senator CARPER. All right. Thanks.

Yes, sir?

Mr. MCKAY. Quickly, we think of oil and gas as the main driver in our business. But on top of that and incremental to that, alternative energy, quick numbers, we have invested $7 billion over the last several years, most of them in the U.S., around wind, biofuels, lignocellulosic biofuels, biobutanol, solar, and then carbon sequestration. It is a growing business. It is difficult, but it is growing.

Senator CARPER. All right. Thank you.

Yes, sir?

Mr. ODUM. Well, we do absolutely consider ourselves an energy company. I would tell you that as a company, internally we look and say we want to be the most innovative and competitive energy company in the world. So that is the perspective we take. We have been in all of the businesses that have been mentioned: wind, solar, hydrogen, and others. The one that is emerging for us as the real opportunity is biofuels.

We have just recently formed a $12-billion joint venture around current technology for producing large-scale amounts of biofuels, as well as in adding to that the very intense research and development we have been doing to take that to the next level. It is exciting stuff. We were talking about using enzymes to speed up the conversion to an ethanol, and another technology that potentially skips the ethanol step and goes straight from a biomass to a gasoline or diesel equivalent. So, it is exciting business.

Senator CARPER. All right. Thanks.

The last one.

Mr. WATSON. Senator, just in addition to some of the comments that have been made here, we are the largest producer of renewables thanks to our geothermal business. That is a very active business for us in Indonesia and the Philippines in particular. We too are making investments in advanced biofuels. We too believe it will be some time before those will come to market.

One opportunity that I think is out there during this transition phase that you were talking about is energy efficiency investments. We have an energy efficiency company that goes in and makes investments in educational institutions and elsewhere to reduce energy consumed. I think that is a big opportunity, and it is a near-term opportunity across this country.

The CHAIRMAN. Thank you, Senator.

Senator CARPER. Thank you very much.

The CHAIRMAN. A couple of us have a couple of follow-up questions here.

Mr. Tillerson, you mentioned comprehensive tax reform, that you are strongly in favor of comprehensive tax reform. I do not think there is anyone here who disagrees with that. But that is easy to say. The question is, what do we mean by comprehensive tax reform? Before I ask you what you mean, the general feeling is, we lower the rate, broaden the base, both in corporate and individual. That seems to be a trend, similar on the individual side, to what

we did in 1986. On the corporate side, we lower the rate. We have the highest corporate rate in the world. Lower it, be more competitive. But broaden the base, try to find a way to do this in a revenue-neutral way.

But by definition, if we are doing that, lowering the rate and broadening the base, that means we are starting to cut back on some incentives. Whether it is biofuels, whether it is solar, geothermal, you name it. Or some of the incentives that you have. Your general advice to us—I would like to ask all five of you—as we pursue tax reform, does that mean to you that maybe we should lower the rate, but also cut back on some of the credits, exclusions, deductions, and so-called tax expenditures? Because, by definition, we have to, otherwise we are going to lose a lot of revenue. And that is hard to do in this big debt/deficit climate.

Mr. TILLERSON. Well, Senator, I would support all of that. When we say comprehensive tax reform, everything for everybody everywhere has to be on the table. So, if you want to talk about section 199, repeal it for everybody across the board—gone. Again, you say you are going to broaden the tax base, if that is coupled with an overall lowering of the corporate income tax rate. I just use 199 because there is a whole host, as you well know, of elements to our tax code that are very complex. I think simplifying the tax code, broadening——

The CHAIRMAN. Well, 199 is probably not a bad example, because some use it, some do not.

Mr. TILLERSON. We are really just creating conditions for greater investment in the country, because we have to grow our way out of this deficit problem. We have to make it more attractive for people to invest, create revenues, broaden that base. That is where a lowering of general rates would be productive.

The CHAIRMAN. But you go along then, though, with the scaling back a lot of the tax expenditures.

Mr. TILLERSON. Across all businesses. Not just ours; across all businesses.

The CHAIRMAN. Yes. I am getting that. All right.

Mr. TILLERSON. And in the foreign tax code, it needs an overhaul as well. The only principles I tend to live by are: make the United States a more attractive place for investment, do not harm American competitiveness overseas because competitiveness brings enormous benefits and wealth back to this country, and keep the playing field level within industries so that everyone competes. We love to compete. I mean, that is what we thrive on, is the competition.

The CHAIRMAN. All right.

Mr. Mulva?

Mr. MULVA. I completely agree. Make it simpler. Make it in a way that is consistent for everyone. Certainty that we do not anticipate changes going forward will promote investment and, I think, additional revenues and will certainly help with respect to employment.

The CHAIRMAN. But do you agree with the general principle that corporate tax reforms should be revenue-neutral?

Mr. MULVA. Yes.

The CHAIRMAN. You do? Thank you.

Mr. McKay?

Mr. MCKAY. I agree as well. Anything that can increase competitiveness for the U.S. in terms of investment I think would be good. I agree with all the comments that have been made. The simpler, the better. The more predictable, the better. Job number one is to get investment up.

The CHAIRMAN. But the way to increase competitiveness, in your view, is how?

Mr. MCKAY. Exactly as we have been saying. If the overall tax rate goes down and is broadened, and some of the complexity is taken out, that should aid competitiveness.

The CHAIRMAN. I do not want to make this too complicated, but as you well know, in the United States, much business income now is no longer corporate income, but is pass-throughs, where it is the individual income taxes which have to be looked at, not corporate, which greatly complicates this question.

Mr. MCKAY. Yes.

The CHAIRMAN. I mean, we have more pass-through business income in this country, I think on a proportionate basis, by far compared with any other country. That is a recent trend. You might want to consider being a pass-through, but, as I go down the list here, let me just give you a chance, Mr. Odum.

Mr. ODUM. I am glad the term "stability and predictability" came up, because that is very important, so I think comprehensive reform with everything on the table. Yes, I agree with the comments that have been made, with the driving policy element being, ensure U.S. competitiveness.

The CHAIRMAN. Mr. Watson?

Mr. WATSON. I agree with the comments that have been made. I would only hope that over time it will raise more revenue because it will promote growth. I think that is really what we are trying to achieve.

The CHAIRMAN. Mr. Tillerson, do you want to say something?

Mr. TILLERSON. Just on your comment, your point about passthroughs and subchapter S partnerships: it is an important one because, as you point out, so many of small and medium-sized businesses are structured as passthroughs under the tax code. Again, in comprehensive tax reform, we are dealing with the corporate tax code, but also the individual tax code. We will have to deal with that.

Once that is structured, then allow those entities to check the box on which they want to file. They do not file under the corporate tax code today because it is not advantageous for them to do so, but if that is restructured they may find the corporate tax code to be more beneficial for their filings than having to file on the individual tax code.

The CHAIRMAN. One minor point here—not so minor, perhaps, from your perspective. That is the dual-capacity question. I think you would agree that your company—all companies—should get a tax credit for foreign taxes paid to a foreign country, and that is the general rule: you get a tax credit. The general rule, too, though, is that you do not get a credit for royalties. You do for income tax paid in that country, but not royalties.

I think the question here is characterizing that payment. Is it a royalty, or is it a tax payment? I think the goal here on the dual-

capacity—there are various ways to structure it—is to make sure that the company—your company, any company—properly gets that tax credit when it is payment of income taxes to that other country, but not as a royalty payment, and it is difficult trying to figure out what accurately is royalty and what accurately is income taxes. That may have something to do with the law, I do not know. But a royalty is a contract for the individual, tax is general applicability to all companies that might make a profit. So we are trying to do the right thing by separating what is a royalty from what is properly a tax payment. That is the goal here.

Mr. TILLERSON. Well, and I appreciate the recognition of that and do not disagree with any of what you just said, Senator. It is challenging dealing with the complexities of the host country's tax system and how is it characterized, payments that we are required to make to them, and how that fits under the U.S. tax code. It is a difficult task, but, as I said, we must prove to the IRS that they are legitimate income taxes, not royalties. So I understand the challenge.

I mean, the alternative is to go to a different system, which I know, because we have talked with your staff, and others have talked about going to a system of foreign tax code that is more in line with what most of the rest of the world has, which would be a territorial system. Then again, it is getting that system structured so that it does not violate that principle of mine, which is, do not structure it such that American companies are at a disadvantage to their competitors overseas. I think that is achievable. As with all things, the devil is in the details, but I think we have a way to move to a system like that. That simplifies an awful lot of the complexities that exist in our current tax code.

The CHAIRMAN. Right. Before I pass this on—this is going to be incredibly difficult.

Mr. TILLERSON. It is, without question.

The CHAIRMAN. It is going to require the good faith of everybody involved. It is analogous to our efforts to try to reduce our debts and deficits. I mean, it has to be shared. Everybody is going to have to give in a little bit here and there, for the greater good.

Senator Hatch?

Senator HATCH. Well, thank you, Mr. Chairman. Mr. Chairman, yesterday on the floor Senators Landrieu and Begich spoke about these hearings and related legislation that was quite critical, so I ask that their statements be placed in the record.

The CHAIRMAN. Without objection.

[The floor statements of Senators Landrieu and Begich appear in the appendix on p. 96.]

Senator HATCH. All right.

Now, Mr. Chairman, I would like to comment on a few items before I go into the second round of questions.

My friend from New York implied that the roughly $60 billion in tax incentives that we are discussing today are a key factor in reducing our $1 trillion-plus deficit. My friend from Maryland made a similar point. Nobody is arguing that the number is insignificant. What we are worried about is what the effect of removal of these domestic production incentives would be.

The testimony is clear. Removing these incentives is going to drive production offshore; it is just that simple. That is what has been said here today. But I will tell you, there were spending cuts of similar size proposed by Dr. Coburn—who is a member of our committee—that were rejected out of hand by my friends on the other side. Those spending cuts, another version of shared sacrifice, to use your terms, did not involve student loans. They did not involve low-income folks. They did not involve infrastructure investment. Here is an example.

Dr. Coburn proposed selling Federal buildings that are defective, vacant. That proposal was doggedly opposed, as reasonable as it is, by my friends on the other side. That proposal involved $80 billion. So let us make no bones about it: there are two sides to what is happening here.

Let me just ask you this, Mr. Tillerson. Combining all of U.S. companies into one large company, if you took all five of you—all U.S. companies, not just the five of you, but all of them—into one large company, if we combined them all, that would give that company control over only 6 percent of the world's oil production, as I understand it. Six percent of the global oil production and control over less than 2 percent of global oil reserves. Yet, we require them to go out into the world of titanic, nationally owned oil companies and still provide us with a continued, large supply of oil.

Let me show you this chart. U.S. companies are the wee, little sliver there. That is 1.4 percent. Look at the OPEC nations, beginning with Saudi Arabian Oil Company, National Iranian Oil Company, Iraq National Oil Company, Kuwait Petroleum, right on down the line. Here is where we are. We are this small little sliver here. All these others are OPEC nations that own those production facilities.

I guess what I am asking you is, you are the Big 5 American companies. Am I wrong on the small slice of petroleum exploration and production that is listed on these charts? Mr. Tillerson?

Mr. TILLERSON. No. I think those numbers show, to my recollection as well, that we do not represent an enormous holding of the reserves or the production. I would say this, though. We do represent an enormously important participant in the development of global energy supplies, and we do work in a number of the OPEC countries.

Senator HATCH. But you do not own all of these.

Mr. TILLERSON. No, no. I mean, what you have would represent our share of what we would own.

Senator HATCH. And that is that little slice in that overall pie.

Mr. TILLERSON. Yes. Yes.

Senator HATCH. Mr. Odum, did I hear you correctly, you were willing to spend $700 million in the Gulf on enough domestic energy production to power more than 600,000 vehicles a day? And I believe you also said that you invested $3.5 billion in the last 5 years to develop large oil reserves in Alaska. Now, is your testimony that Shell has spent over $4 billion to produce domestic oil, but that the only thing standing in your way is the government refusing to allow you to go ahead?

Mr. ODUM. Well, I think the case, as you say, is emphasized by what is happening in Alaska, so we are approximately at some-

thing around $3.5 billion, about 5 to 6 years now, into trying to drill in Alaska, and we have yet to be able to do so because of the permitting situation and overall coordination of the government agencies.

What I tried to emphasize earlier is the impact of something like that. So again, the studies through the University of Alaska indicate that developing that part of the industry could be 750,000 barrels a day on a long-term, multi-decade basis.

Senator HATCH. So you spent $3.5 billion on the project, and you cannot get the doggone permits to do what you know is there.

Mr. ODUM. Exactly. It does not reflect well on the U.S., I am afraid, in terms of drawing investment to this country and being competitive in this business.

Senator HATCH. One of the first acts of Secretary Salazar was to withdraw 77 onshore Federal oil and gas leases in Utah after years of jumping through environmental hoops and we had finally got there. It was an agreement between the Governor and the BLM, after they had already been studied, auctioned off, and paid for. It was one of the strongest anti-oil signals you could have sent to the oil industry. Could you elaborate on your experience, or any of the rest of you, if you would care to?

And also answer this question, before we finish. Assuming this legislation passes, the Menendez legislation, will it bring down the prices of oil at the pump, or is this just a big charade? You do not have to use my terms, but answer that for me. Why are we doing this? Why are we putting you at a disadvantage when you are that little, small slice of the overall pie? You are competing against nations that have oil companies, nationalized oil companies. Go ahead.

Mr. ODUM. Well, I think that the competitiveness point is exactly right. The chart is accurate from what my information would tell me as well. I think the thing we have to be careful not to lose in the chart is what I called earlier this enormous opportunity that exists in the U.S. We have a tremendous number of resources. We can impact the energy balance and the domestic production of that energy balance in the U.S.

Senator HATCH. Well, why do you not do it then?

Mr. ODUM. Well, it is a matter of access.

Senator HATCH. And that of getting the permits.

Mr. ODUM. Which goes far beyond just the limited part of the conversation today, which is around the tax code. I think to look at a real energy policy that provides this industry with access to those resources, we could have a significant impact on the economy, the deficit, the trade balance, and the energy security of this country.

Senator HATCH. I would like to know if any of you believe that this bill will help decrease prices at the pump.

Mr. TILLERSON. No.

Mr. MULVA. No.

Mr. MCKAY. No.

Mr. ODUM. No.

Mr. WATSON. No.

Senator HATCH. And by the way, I know that some people are a little upset that I have taken this time. I sat here while every

Democrat has taken considerable extra time. I am the only one here on the Republican side because everybody had to go to the White House. So I would hope that I could be granted a little bit more time.

The CHAIRMAN. All right.

Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman. I just have one question, but I also want to note where we are at this point 2½ hours into the hearing. Gentlemen, you all have done, as major oil companies, a dramatic about-face this morning. In 2005—you were there, Mr. Mulva—all of you said you did not need tax incentives to drill for oil. Today you have come to say you have to have them, when oil is at $100 a barrel.

I just think that position defies common sense, and certainly, even adjusted for inflation, you are even doing better now than you were in 2005. So this debate is going to go forward, and I just want to make sure that folks who are paying attention to this pick up on that as we wrap up.

I have one last question I want to ask of you, Mr. McKay, because of some of the comments that you have made. That is the tax credit that exists for blending ethanol. Now, as you know, you all are required by law to implement the Federal Renewable Fuel Standard and blend billions of gallons of ethanol into the gasoline that you sell.

Your testimony says, "BP is already one of the largest blenders of ethanol in the Nation." So my question, Mr. McKay, is why should oil companies—it is not just yours, but all of the oil companies—be getting $6 billion a year in tax credits for complying with an existing law to blend ethanol?

Mr. MCKAY. That law was introduced to get ethanol as a biofuel into the fuel mix into the U.S., which has been very successful as an incentive to do that. We are not opposed to that transitional incentive being phased out. We think it was important for transitional incentives for second-generation biofuels.

Senator WYDEN. Well, I think that that is constructive, and I am glad we are noting that.

Mr. Chairman, you and I have talked about this. There is no question in terms of energy policy that often you need an incentive to get something off the ground. Clearly what Mr. McKay is talking about is that this incentive made some sense at the beginning, but it does not make sense now. It involves $6 billion. Mr. McKay, I think it is constructive that you said this morning that you would be willing to phase it out.

Mr. Chairman, I would like to talk with you and Senator Hatch and have further discussions, and I thank you.

The CHAIRMAN. Well, thank you, Senator.

I think Senator Snowe made a good point, too. This committee should, and we will, look at the effectiveness of all the tax expenditures, all the incentives, to see which ones are more effective than others, and maybe we can get rid of a few of them. It reminds me a little bit—and I am sure some of you do not know this; it is a difficult question for all of us—there are about 141 tax provisions in the code that expire every year or every 18 months. We call them expiring provisions. They are a nightmare. It makes no sense

for us to go back and reinvent the wheel 141 times every year or 18 months. They have to be paid for, and it is just maddening. It diverts our time from bigger questions.

So we would be looking at a lot of these provisions and others. I would like to eliminate a lot of those or make them permanent so there is not a lot of uncertainty surrounding them, both from our side and also from the industry side. But anyway, we are going to be looking at a lot of different tax expenditures to see which ones are effective.

Senator Cardin?

Senator CARDIN. Thank you, Mr. Chairman. Let me concur in your comments in regard to tax reform and assure you that there is great interest in making our tax code more competitive and more predictable. I think predictability is extremely important for investors. We have to give you and investors the ability to know what the ground rules are, so we agree on that.

I want to make one comment in response to Senator Hatch. The numbers here, $4 billion as I understand it if all were repealed, equal about 3 percent of the profits of the five companies. Most of these profits are going back to the shareholders. So I just do not see the impact that Senator Hatch is referring to on either jobs or any of the issues that you bring up. I just think the math is pretty——

Senator HATCH. If the Senator would yield. My point is, and I think they are making the point, if you are going to do this, you should treat them fairly along with all the other companies that receive certain tax expenditures. Now, I agree, we have to do tax reform, and that includes looking at everything.

Senator CARDIN. And I agree with that.

Senator HATCH. But I do not want them mistreated just because they are an industry that people hate and because they are "so big."

Senator CARDIN. I understand. Let me bring it back to the point that has been used here. I understand the business is taking, the five companies here are taking, the tax provisions that are there and taking advantage of them. That is your responsibility. If you did not do that, you would have problems with your shareholders. But understand why we think that these are either unwarranted incentives or subsidies, particularly the section 199 deduction.

Section 199 was a response to the fact that our corporate taxes are not border-adjusted versus Europe's and other countries' consumption taxes, which are border-adjusted. So we did something to help our foreign sales. That was the purpose, the genesis, of section 199. We wanted to be able to compensate for the fact that our foreign competitors had an advantage over U.S. manufacturers on the way that taxes were handled at the border.

Now, my understanding is that in your industry there is more imported product than exported product, so it does not make a lot of sense for you to get a tax advantage when this is the philosophy of what this section was originally created for. Now, as you know, the World Trade Organization ruled the previous provisions for foreign sales were out of compliance, and we had to go to a general manufacturing provision. That is how this section came about.

Well, on two fronts, we have questions as to whether this is a reasonable tax advantage to the oil industry. It is not traditional manufacturing, and it is not the type of export activity that was disadvantaged by the corporate structure in having a product enter the international marketplace.

So I just think we have to get to the rationale—this is the largest single source of the revenues we are talking about today—that has its genesis in helping United States manufacturers get a product into the international marketplace, which is not the circumstances of the product that you are basically involved with. You import the crude, as I understand it. The final product is mostly domestic. I am sure some hits the international marketplace, but it is certainly not the target for why this particular tax provision was put in the tax code. Does anyone disagree with that? I knew I would get Mr. Tillerson involved there.

Mr. TILLERSON. Well, if you want to repeal it, repeal it for everyone, because I am not sure that the coffee roasters are growing coffee here and exporting coffee. I am not sure that the newspaper companies are exporting, predominantly, their newspapers. So I do not disagree with your comment or your premise. My only point is, if you want to get rid of it, just get rid of it across the board. Do it for everybody.

Senator CARDIN. I do not disagree with the point.

Mr. TILLERSON. Do not just get rid of it for one industry.

Senator CARDIN. For some manufacturing companies, this is rough justice. It really helps them. I would rather do it directly as we did with foreign sales. We cannot do that under the WTO. I would like to reform our tax code so that we have a competitive base. If we can do that, that is my first choice. If we cannot do it, we should tailor this more to its purpose of helping exporters who manufacture in the United States.

Mr. TILLERSON. My only principle that I ask you not to violate is, do not treat companies within the same industry differently, and do not treat industries on your principle of exports differently.

Senator CARDIN. Well, it is tough sometimes to draw a line. I understand the point that you are raising. All I am pointing out is that that is why some of us look at the section 199 as it relates to the oil industry as either an unjustified incentive or as a subsidy, because we do not believe it is the original intent to benefit your type of activities. I just really want to put that in the record, and I very much appreciate your response.

The CHAIRMAN. Thank you, Senator.

Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman.

I want to repeat, but then expand a little bit, what I said earlier. I really do believe that you are out of touch. I do believe that. Mr. Tillerson does not. That does not mean you are not good people, that you do not participate in your communities, that you do not do helpful things along with the work that you have to do.

But I think the main reason that you are out of touch, particularly with respect to Americans and the sacrifices that we are having to look at here in terms of trying to balance, or come even close to balancing, a budget is that you never lose. You have never lost. You always prevail.

You always prevail in the halls of Congress, and you do that for a whole variety of reasons, because of your lobbyists, because of friends, because of all the places where you do business. I do not really know any other business that never loses, that never fails to do as well as you do.

Then I think one of the problems—and you cannot help this, in a way—is just the size of the amount of money you make is really hard for average people in West Virginia to even come close to understanding. They do not think that that can be come by in the regular order of the way the world treats them. They are always in the process of losing. Everything is an uphill battle.

So my view of my work in West Virginia, which is mostly mountainous, 96 percent mountainous, is that I am holding onto a huge boulder—a not too huge boulder—with both hands and trying to push it uphill. That is every day I feel that. I love that feeling. But I know if I take one hand off, I and the boulder would disappear into the ether, or I guess the opposite of the ether. The gulch.

So that then leads me to say—this is my opinion, but I really believe it, I just really believe it—I have just never seen any industry so successful, so constantly successful, so I think you all have a great sense of assurance as you are sitting there, more so than usual—and we have steel people, automobile people, or other kinds of people there. You have a great sense of assurance. I do not think you feel threatened by anything that is going on here. I do not necessarily know that you have any reason to feel threatened because of the way the votes line up in this present Congress.

But I yearn for one of you to see what average people are going through and to figure out some way in your mind, what can I do as a very, very large and profitable company, to make sure that that bad thing does not happen to that person, losing health insurance or losing unemployment insurance, the endless number of things that people have to worry about every single day? You do not have to worry about those. None of you took a commercial airplane to come here. I do not blame you for that. You have the money to have planes, but our people do not.

So I just want to sort of stipulate that and then say one more thing. The greatest danger to this country right now, other than the deficit, in terms of national security, is something called cyber security. We are writing a bill in the Commerce Committee, and the Homeland Security bill is participating in that, which comes up with a solution which I hope we can pass this year. There is an enormous amount of work and expense that companies have to go to that are being attacked already.

The Pentagon, I think, has had hundreds of thousands, maybe a million times a day, people hacking in, getting secrets, not just WikiLeaks, but anybody can do that. So how do they defend themselves? Well, they have to go to all kinds of security measures. I met with most of them yesterday, particularly the bigger ones. I said, you are going to have to bear that expense. The government cannot do that for you.

We do not have the money to do that for you, because it is going to go on for the next 50 or 100 years, we are going to be facing these problems. They did not object to that. In fact, they said, we think that is the right thing, the way it should be. We should have

to pay more. We should have to dig into our profits to make ourselves more secure.

So that is why, when you talk about the R&D, that your expenses are like research and development for pharmaceutical companies or somebody else, that is why I think it is wrong of you to say that, because it just is not. So much of that exploration has already been done. I think that is a cost that you could absorb so easily and still do very well.

But not once during this hearing have I heard any semblance of a willingness to share unless every other company also has to, which is a way of kind of building up the defense that it cannot happen.

Well, putting it more simply, I have not heard anybody talk about what they are doing, what they would be willing to do to share in our budget problem, and in the total concept of what keeps America together, and that is a sense of fairness, that everybody has to lose at some time, everybody has to give something up for us to be a real country.

Do any of you have any things—if you just do not add on, so long as every other company does it too—do any of you think about this, things you could give up, things you could just stop doing, breaks that you now get that you would not get, as a way of helping?

Mr. MULVA. Senator, I very much appreciate the comments that you are making. I can only represent how we as a company feel. I do not know how the others feel. But we feel like we are constrained and restricted from our opportunities. We feel we are in a noble industry that provides the energy that has developed this country into what it is and its standard of living, and we are constrained from what we feel could be a part of the energy solution for this country and for the world. But we are constrained, there are shackles on us. We are ready to invest. We are ready to do far more; you have heard today. So it is not a question of looking for incentives. We are looking for—put us back to work. Give us access to the lands. Let us start drilling. Put our people back to work, and we will develop assets——

Senator ROCKEFELLER. I am way past my time. But can I just say that we feel constrained, we cannot do what we want to do? Maybe you are right and maybe you are wrong. I think you are wrong. I think the great bulk of our people across the country are suffering in ways that you probably had no idea of or just do not understand. I think that is sad.

The CHAIRMAN. Thank you, Senator.

Which opens up another subject, and that is leases. I would just like an answer for my own information. I do not know the answer. I have not discussed this at any great length with anybody in the industry. But I have heard you often say, and have said previously, that you would like to have more access around America, whether it is the Gulf, the North Slope, wherever it is, more access, permits so you can do your work, as you said, Mr. Mulva.

But on the other hand, I hear some people say—and this is the question I have—that there are millions of acres of leases that you own which you are not utilizing. I am just curious what your response is to that, if there is one, because it does come up quite frequently, that question.

Mr. ODUM. If I could just start. I mean, I am going to take you back to Alaska again and try to put this in perspective.

The CHAIRMAN. How many——

Mr. ODUM. I will put it in terms of——

The CHAIRMAN. I am just curious.

Mr. ODUM. I will put it in terms of leases.

The CHAIRMAN. Yes.

Mr. ODUM. So, in the Gulf of Mexico, we are one of the top three, and sometimes the second- or third-largest operator in the Gulf of Mexico. We have between 400 and 500 leases, and about 35 percent of those are producing. The rest are in some stage of evaluation or being drilled, and so forth.

If you compare it to Alaska, we have over 400 leases in Alaska that are sitting idle, waiting for permission to move forward, just to put that question into balance.

The CHAIRMAN. All right. Anybody else? Yes?

Mr. WATSON. Senator, perhaps I can comment on lead times. A lot has been said about leases that are undeveloped. We just made a final investment decision last year on a Jack/St. Malo development. This is in 7,000 feet of water. It is a $7.5-billion commitment. We made that commitment during the moratorium on the expectation that we would get permits, which I expect we will, to drill the development wells.

Those leases were first issued in the late 1990s, and we did not know how to explore or develop in that deep of water. Technology has advanced. We have done exploration work, we have done exploratory drilling, we have done delineation drilling. Now we have made a decision that will result in production in 2014. So there is a long lead time in the offshore area, which is where most of the undeveloped leases are today.

Now, we are having trouble getting permitting on the leases that we have, which is keeping those leases inactive. So I think, when you hear us talking about the opportunity that is there, one is to make sure that we have timely issuance of permits on the acreage we already have so that we can continue to explore. The other is making sure that the outer continental shelf is fully explored. The U.S. Geological Survey and others have made estimates that you could create companies twice the size of Chevron with the resources that we have not developed yet. Now, we will not know what we have until we explore those areas, but that is the opportunity that we are talking about.

The CHAIRMAN. My second question is, again, your public reports show, I think it was in 2010, that about 60 percent of your after-tax profits were invested in stock repurchase or dividends, and so forth, and about 40 percent elsewhere. I suppose that is reinvestment, I do not know. That seems to a lot of people, gee, a lot of money is going back to shareholders, and a lot of money that you are making is going to stock repurchase. Why is more of that not going into reinvestment? So that is the first question.

The second question is, how does that percentage compare with other industries? That may or may not be relevant, but it is just a question that came to my mind.

Mr. Tillerson?

Mr. TILLERSON. Well, last year we earned about $30 billion. We invested $32 billion, so we invested more than we earned. With that cash flow, the first thing we do is we pay all of our expenses, we pay our people, their salary, wages, and benefits, we pay all our bills. We pay our taxes. We fund our opportunities, $32 billion worth. Then what is left over, we pay the dividend. If there is anything left beyond that, then we return that to shareholders through share repurchases. It is their money. They invested it with us, they entrusted us with their savings to go invest it, grow it, and give them some income back. So I know it is a novel thought up here in Washington, but we actually give the money that belongs to our investors back to them if we do not need it.

The CHAIRMAN. I appreciate what you said. Maybe this is inaccurate. I have a chart here. It is a Form 10–K for Exxon Mobil. I have also ConocoPhillips, Chevron, and Shell here, for 2010. It says, according to this chart, stock repurchases and dividends as a percent of profit in 2010 was 70 percent, and for ConocoPhillips it was 77 percent. That is the data. We are not trying to fudge anything. I just look at the——

Mr. TILLERSON. That is roughly consistent with the numbers I just gave you.

The CHAIRMAN. All right. So, you mentioned $32 billion in profit.

Mr. TILLERSON. Thirty billion in profits. My recollection is, we returned $19-plus billion to shareholders last year. I do not have the number immediately in front of me.

The CHAIRMAN. Anyway, I think when the public sees this, they will think, well, gee, it would be better if we used that money to go back for more jobs, more investment, and so forth. But I understand the shareholders own the company. Your board of directors——

Mr. TILLERSON. We would love to. Give us something to work on. We would love to.

Mr. WATSON. Senator?

The CHAIRMAN. How about a trade here: more leases, give up the tax breaks.

Mr. TILLERSON. I do not think I came to negotiate a trade with you today, Senator. I came to answer your questions.

The CHAIRMAN. That just popped in my mind. [Laughter.]

Mr. WATSON. Senator, I would just offer that Chevron paid $5.6 billion in dividends last year to our shareholders. Ultimately, those dividends are taxed, and the government receives revenue. We do not repurchase very many shares, but when we do our stock has gone up $30 or $40 in the last couple of years. There is a nice gain on that.

The CHAIRMAN. Of course.

Mr. WATSON. That generates tax revenue for the government as well, and the money is then reinvested where the investor thinks it is appropriate. So the country still benefits from it.

The CHAIRMAN. All right.

Do you have more questions?

Senator HATCH. Yes, I do.

The CHAIRMAN. All right. Senator Hatch.

Senator HATCH. Yesterday in the *Wall Street Journal*, former Democratic Congressman Harold Ford, a good friend of mine,

asked, “Why, when gas prices are climbing, would any elected official call for new taxes on energy?” I thought that was a pretty interesting question coming from a Democrat.

I think it is a good question. In your testimony, you say that changing important tax provisions outside the context of broader corporate tax reform would achieve one unmistakable outcome. It would restrain domestic development and reduce tax revenues at a time when they are most needed.

Would you folks please elaborate on the negative economic consequences of the proposed selected or selective tax increases that the Menendez bill would impose on only your industry, not all the others who have similar tax expenditures or tax deductions?

Mr. WATSON. Certainly. To the extent that taxes are increased, it impacts the economic valuations we go through, and we will spend less. Natural gas prices are low today. Deep water developments are very expensive. Costs have more than doubled over the last few years. To the extent more onerous tax provisions are placed on us, we will spend less money on development. That will translate to less oil and gas produced in this country.

Senator HATCH. All right.

Does anybody else care to comment on that, or do you all agree with that?

[No response.]

Senator HATCH. All right. Well, this business of dual-capacity rules came up today. Generally all U.S.-based companies are entitled to a foreign tax credit against U.S. tax based on foreign taxes that they pay. Now, you mentioned that we would be really wise to go to a territorial system just like everybody else in the world has. But our system is some screwed-up system where we are constantly trying to find ways of resolving some of the difficulties when you earn monies overseas and are taxed by the countries overseas.

But let me go through this. So generally, all U.S.-based companies are entitled to a foreign tax credit against U.S. tax based on foreign taxes that they pay. In general, foreign-based multinationals do not claim much U.S. foreign tax credit.

But it is essential to most American companies with global operations. Now, the dual-capacity rules currently in place determine to what extent a payment from a U.S. company to a foreign government is equivalent to an income tax, and thus eligible for the foreign tax credit, and to what extent such payment is for specific economic benefit, such as for the purchase of oil from the foreign government or for the right to upgrade a gambling casino, and thus only a deductible business expense (and not eligible for a foreign tax credit).

Now, my first question is for anyone on the panel who cares to answer. Is it true that repeal of the dual-capacity rules would be very harmful to American-based oil companies, but that such repeal would be of negligible effect to foreign-based oil companies? The second question is, to the best of my knowledge, the dual-capacity rules are only of significant benefit to two sectors in the United States, the oil and gas sector and the gambling and casino sector.

Can any of you confirm that it is the case that the recent proposal, S. 940, would still allow the gambling casinos, such as MGM Resorts, Caesar's Entertainment, Wynn Resorts, Boyd Gaming, and Las Vegas Sands, to claim the benefit of dual-capacity rules while you would not be able to? Now, just to make sure I have understood correctly, I will summarize. The proposal before us, it seems to me, would harm American oil companies but would not harm foreign oil companies and would not harm gambling casinos. I am not for harming those. Am I wrong on that?

Mr. WATSON. I do not know that much about the gambling business, but I can tell you, when tax rates exceed the U.S. rate overseas, if we do not have dual-capacity tax treatment, we will be ceding business over time to our foreign rivals, whether they are Chinese national oil companies, Russian oil companies, even European companies. So it is very important.

I would further add that the Internal Revenue Service is well-able to distinguish between royalties and taxes. There are very few areas of the tax code that have been studied more than this subject, so that may have been a difficulty years ago, but there is abundant case law and abundant rules to determine the difference between a royalty and a tax. It is important that we be allowed to take tax credits where we have already paid taxes overseas.

Senator HATCH. Would anybody else care to comment?

Mr. TILLERSON. Well, I would just echo John's comments, that it would have a devastating impact on our ability to compete overseas. This is one topic where you will not find the five companies aligned, because two of my foreign-owned competitors are at the table. They operate under a territorial system, so we would lose competitiveness relative to them.

Then, in an already very crowded and enormously competitive world we find ourselves in, in the resource development space, because of the growing presence of the national oil companies—which already come to the game with other advantages that we do not have nor do we seek—we have to offset that by finding other ways to out-compete them. What we would like to have is at least a level playing field from a tax standpoint and not be at a disadvantage.

Senator HATCH. I pointed out what a small slice you are of the world. You are competing with national oil companies, national international oil companies, I guess you would have to say.

Well, let me just finish with this comment, Mr. Chairman. If I have you all correctly here, what you are saying is that it would be very unfair to pass this type of legislation because it would be selective taxation against, peculiarly, your industry that other industries in this country benefit from, and that that just does not seem right to you, as far as I can see, I mean, if I am summarizing this properly. You can surely correct me if I am not summarizing it in the right way.

That would be an unfair approach and would make you less competitive if that happened. That would cost jobs, and most importantly of all, it would cost real jobs because you employ a lot of people. If you could do your work up there in Alaska, my gosh, you would put a lot of people to work.

Alaska would benefit greatly. It is costly coming to the Congress asking for help, where the oil business has really helped Alaska

over the years. You would put these people to work and, frankly, if I understand this hearing and what you are all saying, it would be unfair and probably—well, not probably. The bottom line is, and I do not think any of you will disagree with this, it will not bring down gas at the pump one penny. In fact, it is likely to go up because of the selective taxation approach. Is that right?

[No response.]

The CHAIRMAN. Thank you, Senator.

This concludes the hearing. I will end, though, where I began, namely just to remind all of us here, we have a fiscal problem on our hands, a Federal fiscal problem. Let us get these deficits down. We have to make choices. None of them is easy. I, twice a week, go over to the Blair House and meet with the Vice President and a couple other members of the Senate, a couple from the House, Secretary Geithner, OMB Director Jack Lew, Gene Sperling, the President's economic advisor, going down lists, trying to figure out how we do this. It is not easy.

Agriculture—you tell me how many farmers want their commodity supports cut? Conservation programs, food stamps—I mean, you name it, this is not fun stuff. I just urge all of you to keep that in mind. When you go back to your daily work and so on and so forth, maybe talk to your people and say, gee, maybe there is a way we can contribute here, too.

Because we are in this together, and everybody here clearly wants more jobs, more growth, wants America to be number one, to have incentives to invest in the United States so foreign corporations, foreign investors invest more in the United States. If we can do that more, American investors will invest more in the United States, if we find incentives to do that while we also probably reform the corporate and individual income tax system. There are other measures clearly which encourage investment.

So this hearing is concluded, but to be honest with you, I am not totally convinced that these provisions add that much to your decisions in where you invest or do not invest, or, if they are taken away or substantially reduced, would make that much difference, given the huge profit margin which exists because the price of oil is just so high.

I agree with Senator Hatch: this is not going to change the price at the gasoline pump. That is not the issue. I do not see that as an issue at all. The issue I see is, who shares and how much does each segment share as we try to get our debt and deficits under control, and at the same time develop an energy policy?

Senator HATCH. Mr. Chairman?

The CHAIRMAN. I grant you, we have to develop energy policy in this country. It does not have an energy policy. There is a lot we have to do, but we also have to figure out how we get our debt and deficit down.

Senator HATCH. Mr. Chairman, just one last comment. I agree with you, and I know that you are sincerely devoted to doing that. I appreciate it, and it is an honor for me to serve with you. My problem is, there is not a real good reason for raising this because I guarantee you, if they raise these taxes, Congress will spend every dime of it. It will not go to pay down the deficit. We do not have the capacity right now, or even a Gramm-Rudman bill—that

might work better—that would cause this money to go to pay down the deficit. I guarantee you, if you raise taxes——

The CHAIRMAN. Senator, I respectfully disagree. The reason I disagree is because we have to. We have to get these deficits and debts down so we do not bump up against the debt limit, so we do not default, so we do not bump against the limit. We have to get our debts and deficits down so this country is on sound financial footing. We will do it because we have to do it.

The hearing is concluded.

[Whereupon, at 12:18 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding Oil and Gas Tax Breaks
As prepared for delivery

In 2005, President George W. Bush said, "With $55 oil, we don't need incentives to oil and gas companies to explore. There are plenty of incentives."

Today, oil costs more than $100 a barrel.

So today we will again evaluate those oil and gas incentives. We will consider how they have affected profits in the industry and prices at the pump.

We will ask the same question our 43rd President answered more than five years ago: Is it wise to continue these tax breaks given to the largest oil and gas companies every year?

Gas prices are nearly $4 a gallon today, and experts anticipate they will remain close $4 for the remainder of the season. That means gas prices are up more than $1 a gallon compared to last summer.

In fact, families will pay an average of about $825 more for gas this year than they did last year. And in rural areas like Montana, where people drive farther, the increase is more like $1,200 per household.

At the same time, the five largest oil companies, who are here today, collectively earned over $35 billion in profits in the first quarter of 2011 alone. At this pace, 2011 will be their most profitable year ever.

Businesses should make a profit – that's what drives our economy – but do these very profitable companies actually need taxpayer subsidies?

Energy incentives should help us build the energy future we want to see – not pad oil company profits. Americans want us to work toward an energy future made in America. They want us to develop energy sources that won't be depleted, like the wind and the sun.

We can't reduce our use of fossil fuels overnight, but investments in clean energy will move us away from the oil and gas bills that are squeezing consumers today.

To reach a clean, American-made energy future, we have to scrutinize every dollar of energy subsidies we spend.

The $2.1 billion we spend every year on subsidies for the largest oil and gas companies are not moving us closer to our energy goals.

Today, everyone's budgets are tight. Congress is debating the best way to address our deficits and debt. Some are proposing cutting Medicare for seniors or slashing Pell grants for students. This sacrifice must be shared fairly. So we have to take a hard look at every subsidy and every spending program to be sure we are using our dollars wisely.

In 2004, Congress created the Domestic Manufacturing Deduction, often referred to as Section 199. The deduction is designed to stimulate manufacturing here in America. Each company here today has claimed this deduction.

But what have taxpayers received in return? Have these tax breaks proven to be more valuable than Medicare or Pell grants?

These tax breaks have not lowered prices. When these tax breaks were created, retail gasoline prices averaged about $1.80 per gallon.

In fact, prices have gone up. By 2008, prices had risen to an average of $3.26 per gallon. Last week, they approached $4 per gallon.

Furthermore, these tax breaks have not moved us towards energy independence. According to Treasury Department estimates, if all the subsidies for the oil and gas industry were eliminated, domestic production would fall by less than one half of one percent.

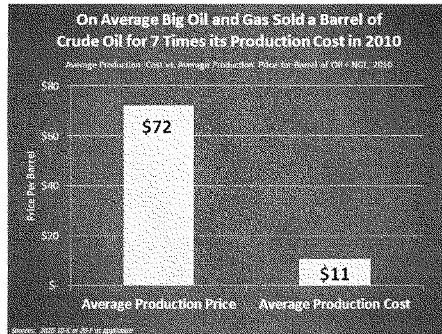
Today, we are only talking about the five largest companies, producers of only one-third of all domestic oil. The Big Five have the most resources and are the least dependent on government subsidies, so the effect on domestic production from repealing the subsidies for these companies would be even less.

Despite these facts, some still argue that eliminating tax breaks for the largest oil and gas companies will raise prices at the pump or force layoffs. The oil and gas industry has launched ad campaigns arguing that repealing these tax breaks will hurt consumers.

But a 2007 Joint Economic Committee analysis found that repealing the oil and gas tax breaks would not raise energy prices for consumers. Why?

Oil prices are set on a world market, and the U.S. share of production is only 10 percent. That makes it difficult – if not impossible – to pass on the cost of losing these subsidies to consumers.

Given profits of $35 billion in just the first quarter alone, it's hard to find evidence that repealing these subsidies would cut domestic production or cause layoffs. After all, based on first quarter profits, these tax breaks represent less than two percent of what these companies are on pace to make this year. Even without these tax breaks, these companies would clearly be highly profitable.



This chart looks at financial documents the companies here today have filed with the Securities and Exchange Commission. According to those documents, the average cost to produce a barrel of oil was $11 in 2010. The average price these companies received for a barrel of oil was $72.

Today, oil prices are higher – a lot higher, almost 40 percent higher – which would increase these large profit margins even further. So it is hard to imagine that companies faced with these opportunities would cut production.

Some might argue that these subsidies or these record profits create much-needed jobs. But those same SEC documents show that nearly 60 percent of these companies' 2010 profits went to stock buybacks and dividends, not job creation.

We can put this money to better use – and we should.

We should use this money to reduce our deficit instead of putting the burden on seniors and on our children's future.

We should use it to move this country toward a cleaner, American-made energy future.

And we should act now.

###

DESCRIPTION OF PRESENT LAW AND SELECT PROPOSALS RELATING TO THE OIL AND GAS INDUSTRY

Scheduled for a Public Hearing
Before the
SENATE COMMITTEE ON FINANCE
on May 12, 2011

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

May 11, 2011
JCX-27-11

CONTENTS

Page

INTRODUCTION ... 1

I. PRESENT LAW TAX INCENTIVES FOR OIL AND GAS PRODUCTION ... 2

A. Credit for Enhanced Oil Recovery Costs (sec. 43) ... 2

B. Marginal Well Tax Credit (sec. 45I) ... 2

C. Expensing of Intangible Drilling Costs (sec. 263(c)) ... 3

D. Deduction for Qualified Tertiary Injectant Expenses (sec. 193) ... 4

E. Amortization Period for Geological and Geophysical Costs (sec. 167(h)) ... 5

F. Percentage Depletion (secs. 613 and 613A) ... 6

G. Deduction for Income Attributable to Domestic Production of Oil and Gas (sec. 199) ... 10

H. Exception from Passive Loss Rules for Working Interests in Oil and Gas Property (sec. 469) ... 12

II. RULES OF GENERAL APPLICATION IMPORTANT TO THE OIL AND GAS INDUSTRY ... 14

A. Dual-Capacity Taxpayers ... 14

B. Last-In, First-Out Inventory Accounting Method ... 18

III. SELECTED PROPOSALS TO LIMIT OIL AND GAS TAX INCENTIVES ... 20

A. Description of the President's Proposal for Fiscal Year 2012 ... 20

B. Description of the Revenue Provisions in S. 940 ... 20

C. Proposed Tax on Severance of Crude Oil and Natural Gas from the Outer Continental Shelf in the Gulf of Mexico ... 21

INTRODUCTION

The Internal Revenue Code includes a number of tax provisions that provide favorable treatment to investment in oil and gas production projects. These incentives include the enhanced oil recovery credit, the marginal wells credit, the expensing of intangible drilling costs, the deduction for using tertiary injectants, the passive loss exemption for working interests in oil and gas properties, percentage depletion, the domestic manufacturing deduction for oil and gas production, and accelerated amortization for geological and geophysical expenses.

Some of these incentives are available to all domestic producers and all domestic production, while others target smaller producers or production that utilizes specific types of extractive technologies. Some of the incentives are not available (or are only partially available) to oil and gas producers whose production activities are integrated with refining and retail sales activities.[1]

In addition to these industry specific incentives, there are several provisions of general application that are particularly important to the oil and gas sector. These include the rules for dual capacity taxpayers and the last-in first-out method of accounting.

The Senate Committee on Finance has scheduled a public hearing on May 12, 2011, on oil and gas tax incentives and rising energy prices. This document,[2] prepared by the staff of the Joint Committee on Taxation, provides a description of various aspects of present law relating to the oil and gas industry along with related proposals to modify certain existing rules and make further proposed changes.

---

[1] Integrated oil companies subject to these limitations are oil and gas producers that sell more than $5 million of retail product per year or refine more than 75,000 barrels of oil per year. Major integrated oil companies are a subset of integrated oil companies that (1) have average daily worldwide production exceeding 500,000 barrels per year, (2) had gross receipts in excess of $1 billion in 2005, and (3) own at least a 15 percent interest in a refinery that produces more than 75,000 barrels of oil per year.

[2] This document may be cited as follows: Joint Committee on Taxation, *Description of Present Law and Select Proposals Relating to the Oil and Gas Industry*, (JCX-27-11) May 11, 2011. This document can also be found on our website a www.jct.gov.

I. PRESENT LAW TAX INCENTIVES FOR OIL AND GAS PRODUCTION

A. Credit for Enhanced Oil Recovery Costs (sec. 43)[3]

Taxpayers may claim a credit equal to 15 percent of qualified enhanced oil recovery ("EOR") costs.[4] Qualified EOR costs consist of the following designated expenses associated with an EOR project: (1) amounts paid for depreciable tangible property; (2) intangible drilling and development expenses; (3) tertiary injectant expenses; and (4) construction costs for certain Alaskan natural gas treatment facilities. An EOR project is generally a project that involves increasing the amount of recoverable domestic crude oil through the use of one or more tertiary recovery methods (as defined in section 193(b)(3)), such as injecting steam or carbon dioxide into a well to effect oil displacement.

The EOR credit is ratably reduced over a $6 phase-out range when the reference price for domestic crude oil exceeds $28 per barrel (adjusted for inflation after 1991; $42.57 for 2010). The reference price is determined based on the annual average price of domestic crude oil for the calendar year preceding the calendar year in which the taxable year begins.[5] The EOR credit is currently phased-out.

Taxpayers claiming the EOR credit must reduce by the amount of the credit any otherwise allowable deductions associated with EOR costs. In addition, to the extent a property's basis would otherwise be increased by any EOR costs, such basis is reduced by the amount of the EOR credit.

B. Marginal Well Tax Credit (sec. 45I)

The Code provides a $3-per-barrel credit (adjusted for inflation) for the production of crude oil and a $0.50-per-1,000-cubic-feet credit (also adjusted for inflation) for the production of qualified natural gas. In both cases, the credit is available only for domestic production from a "qualified marginal well."

A qualified marginal well is defined as a domestic well: (1) production from which is treated as marginal production for purposes of the Code percentage depletion rules; or (2) that during the taxable year had average daily production of not more than 25 barrel equivalents and produces water at a rate of not less than 95 percent of total well effluent. The maximum amount of production on which a credit may be claimed is 1,095 barrels or barrel equivalents.

---

[3] Except where noted, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

[4] Sec. 43.

[5] Secs. 43(b) and 45K(d)(2)(C).

The credit is not available if the reference price of oil exceeds $18 ($2.00 for natural gas). The credit is reduced proportionately for reference prices between $15 and $18 ($1.67 and $2.00 for natural gas).[6] Currently the credit is phased out completely.

In the case of production from a qualified marginal well which is eligible for the credit allowed under section 45K for the taxable year, no marginal well credit is allowable unless the taxpayer elects not to claim the credit under section 45K with respect to the well. The section 45K credit is currently expired with respect to qualified natural gas and oil production. The credit is treated as a general business credit. Unused credits can be carried back for up to five years rather than the generally applicable carryback period of one year.

C. Expensing of Intangible Drilling Costs (sec. 263(c))

The Code provides special rules for the treatment of intangible drilling and development costs ("IDCs"). Under these special rules, an operator or working interest owner[7] that pays or incurs IDCs in the development of an oil or gas property located in the United States may elect either to expense or capitalize those costs.[8]

IDCs include all expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil and gas. In addition, IDCs include the cost to operators of any drilling or development work done by contractors under any form of contract, including a turnkey contract. Such work includes labor, fuel, repairs, hauling, and supplies which are used (1) in the drilling, shooting, and cleaning of wells; (2) in the clearing of ground, draining, road making, surveying, and geological works as necessary in preparation for the drilling of wells; and (3) in the construction of such derricks, tanks, pipelines, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of oil and gas. Generally, IDCs do not include expenses for items that have a salvage value (such as pipes and casings) or items that are part of the acquisition price of an interest in the property.[9] They also do not include (1) the cost to operators payable only out of production or gross or net proceeds from production, if the amounts are depletable income to the recipient, and (2) amounts properly allocable to the cost of depreciable property.

If an election to expense IDCs is made, the taxpayer deducts the amount of the IDCs as an expense in the taxable year the cost is paid or incurred. Generally, if IDCs are not expensed,

[6] The dollar amounts for purposes of calculating the reduction in credit are adjusted for inflation for tax years beginning in a calendar year after 2005. Sec. 45I(b)(2)(B).

[7] An operator or working interest owner is defined as a person that holds an operating or working interest in any tract or parcel of land either as a fee owner or under a lease or any other form of contract granting operating or working rights.

[8] Sec. 263(c).

[9] Treas. Reg. sec. 1.612-4(a).

but are capitalized, they may be recovered through depletion or depreciation, as appropriate. In the case of a nonproductive well ("dry hole"), IDCs may be deducted at the election of the operator.[10] For an integrated oil company that has elected to expense IDCs, 30 percent of the IDCs on productive wells must be capitalized and amortized over a 60-month period.[11]

Notwithstanding the fact that a taxpayer has made the election to deduct IDCs, the Code provides an additional election under which the taxpayer is allowed to capitalize and amortize certain IDCs over a 60-month period beginning with the month the expenditure was paid or incurred.[12] This election applies on an expenditure-by-expenditure basis; that is, for any particular taxable year, a taxpayer may deduct some portion of its IDCs and capitalize the rest under this provision. The election allows a taxpayer to reduce or eliminate the IDC adjustments or preferences under the alternative minimum tax ("AMT").

The election to deduct IDCs applies only to those IDCs associated with domestic properties.[13] For this purpose, the United States includes certain wells drilled offshore.[14]

Pursuant to a special exception, the uniform capitalization rules do not apply to IDCs incurred with respect to oil or gas wells that are otherwise deductible under the Code.[15]

D. Deduction for Qualified Tertiary Injectant Expenses (sec. 193)

Taxpayers engaged in petroleum extraction activities may generally deduct qualified tertiary injectant expenses used while applying a tertiary recovery method, including carbon dioxide augmented waterflooding and immiscible carbon dioxide displacement.[16] The deduction

---

[10] Treas. Reg. sec. 1.612-4(b)(4).

[11] Sec. 291(b)(1)(A). The IRS has ruled that, if a company that has capitalized and begun to amortize IDCs over a 60-month period pursuant to section 291 ceases to be an integrated oil company, it may not immediately write off the unamortized portion of the capitalized IDCs, but instead must continue to amortize the IDCs so capitalized over the 60-month amortization period. Rev. Rul. 93-26, 1993-1 C.B. 50.

[12] Sec. 59(e)(1).

[13] In the case of IDCs paid or incurred with respect to an oil or gas well located outside of the United States, the costs, at the election of the taxpayer, are either (1) included in adjusted basis for purposes of computing the amount of any deduction allowable for cost depletion or (2) capitalized and amortized ratably over a 10-year period beginning with the taxable year such costs were paid or incurred (sec. 263(i)).

[14] The term "United States" for this purpose includes the seabed and subsoil of those submarine areas that are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources (i.e., the Continental Shelf area) (sec. 638).

[15] Sec. 263A(c)(3).

[16] Sec. 193. Prior to the enactment of section 193, the income tax treatment of tertiary injectant costs was unclear. In enacting section 193, Congress sought to clarify the tax treatment and encourage the use of qualified

is available even if such costs are otherwise subject to capitalization. The deduction is permitted for the later of--(1) the tax year in which the injectant is injected or (2) the tax year in which the expenses are paid or incurred.[17] No deduction is permitted for expenditures for which a taxpayer has elected to deduct such costs under section 263(c) (intangible drilling costs) or if a deduction is allowed for such amounts under any other income tax provision.[18]

A "qualified tertiary injectant expense" is defined as any cost paid or incurred for any tertiary injectant (other than a recoverable hydrocarbon injectant) which is used as part of a tertiary recovery method.[19] The cost of a recoverable hydrocarbon injectant (which includes natural gas, crude oil and any other injectant with more than an insignificant amount of natural gas or crude oil) is not a qualified tertiary injectant expense unless the amount of the recoverable hydrocarbon injectant in the qualified tertiary injectant is insignificant.[20]

E. Amortization Period for Geological and Geophysical Costs (sec. 167(h))

Geological and geophysical expenditures ("G&G costs") are costs incurred by a taxpayer for the purpose of obtaining and accumulating data that will serve as the basis for the acquisition and retention of mineral properties by taxpayers exploring for minerals.[21] G&G costs incurred by independent producers and smaller integrated oil companies[22] in connection with oil and gas exploration in the United States may generally be amortized over two years.[23]

---

tertiary injectants. See, e.g., Joint Committee on Taxation, *General Explanation of the Crude Oil Windfall Profit Tax Act of 1980* (JCS-1-81), January 29, 1981, pp. 114-115.

[17] Treas. Reg. sec. 1.193-1.

[18] Sec. 193(c).

[19] Sec. 193(b). A tertiary recovery method is any of the nine methods described in section 212.78(c)(1) - (9) of the June 1979 energy regulations, as defined in former section 4996(b)(8)(C), or any other method approved by the IRS.

[20] Sec. 193(b)(2). Treas. Reg. sec. 1.193-1(c)(3) provides that an injectant contains more than an insignificant amount of recoverable hydrocarbons if the fair market value of the recoverable hydrocarbon component of the injectant, in the form in which it is recovered, equals or exceeds 25 percent of the cost of the injectant.

[21] Geological and geophysical costs include expenditures for geologists, seismic surveys, gravity meter surveys, and magnetic surveys.

[22] Integrated oil companies are oil and gas producers that sell more than $5 million of retail product per year or refine more than 75,000 barrels of oil per year.

[23] This amortization rule applies to G&G costs incurred in taxable years beginning after August 8, 2005, the date of enactment of the Energy Policy Act of 2005, Pub. L. No. 109-58. Prior to the effective date, G&G costs associated with productive properties were generally deductible over the life of such properties, and G&G costs associated with abandoned properties were generally deductible in the year of abandonment.

Major integrated oil companies[24] are required to amortize all G&G costs over seven years for costs paid or incurred after December 19, 2007 (the date of enactment of the Energy Independence and Security Act of 2007 ("EISA")).[25] A major integrated oil company, as defined in section 167(h)(5)(B), is an integrated oil company[26] which has an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, had gross receipts in excess of one billion dollars for its last taxable year ending during the calendar year 2005, and generally has an ownership interest in a crude oil refiner of 15 percent or more.

In the case of abandoned property, remaining basis may not be recovered in the year of abandonment of a property, but instead must continue to be amortized over the remaining applicable amortization period.

F. Percentage Depletion (secs. 613 and 613A)

In general

Depletion, like depreciation, is a form of capital cost recovery. In both cases, the taxpayer is allowed a deduction in recognition of the fact that an asset is being expended to produce income.[27] Certain costs incurred prior to drilling an oil or gas property or extracting minerals are recovered through the depletion deduction. These include the cost of acquiring the lease or other interest in the property.

Depletion is available to any person having an economic interest in a producing property. An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in minerals in place, and secures, by any form of legal relationship, income derived from the extraction of the mineral, to which it must look for a return of its capital. Thus, for example, both working interests and royalty interests in an oil- or gas-producing property constitute economic interests, thereby qualifying the interest holders for depletion deductions with respect to the property. A taxpayer who has no capital investment in the mineral deposit, however, does not acquire an economic interest merely by possessing an economic or pecuniary advantage derived from production through a contractual relation.

[24] Major integrated oil companies are a subset of integrated oil companies that (1) have average daily worldwide production exceeding 500,000 barrels per year, (2) had gross receipts in excess of $1 billion in 2005, and (3) own at least a 15 percent interest in a refinery that produces more than 75,000 barrels of oil per year.

[25] Pub. L. No. 110-140. Prior to the enactment of the Energy Independence and Security Act of 2007, major integrated oil companies were required to amortize G&G costs paid or incurred after May 17, 2006 over five years, as provided in Energy Tax Incentives Act of 2005.

[26] Generally, an integrated oil company is a producer of crude oil that engages in the refining or retail sale of petroleum products in excess of certain threshold amounts.

[27] In the context of mineral extraction, depreciable assets are generally used to recover depletable assets. For example, natural gas gathering lines, used to collect and deliver natural gas, have a class life of 14 years and a depreciation recovery period of seven years.

Two methods of depletion are currently allowable under the Code: (1) the cost depletion method, and (2) the percentage depletion method.[28] Under the cost depletion method, the taxpayer deducts that portion of the adjusted basis of the depletable property which is equal to the ratio of units sold from that property during the taxable year to the number of units remaining as of the end of taxable year plus the number of units sold during the taxable year. Thus, the amount recovered under cost depletion may never exceed the taxpayer's basis in the property.

Under the percentage depletion method, a percentage, varying from five percent to 22 percent, of the taxpayer's gross income from a producing property is allowed as a deduction in each taxable year.[29] The Code generally limits the percentage depletion method for oil and gas properties to independent producers and royalty owners.[30] Such producers and royalty owners may generally claim percentage depletion at a rate of 15 percent.[31]

The amount deducted generally may not exceed 50 percent (100 percent in the case of oil and gas properties) of the taxable income from the property in any taxable year.[32] Additionally, the percentage depletion deduction for all oil and gas properties may not exceed 65 percent of the taxpayer's overall taxable income for the year (determined before such deduction and adjusted for certain loss carrybacks and trust distributions).[33] Because percentage depletion, unlike cost depletion, is computed without regard to the taxpayer's basis in the depletable property, cumulative depletion deductions may be greater than the amount expended by the taxpayer to acquire or develop the property.

A taxpayer is required to determine the depletion deduction for each property under both the percentage depletion method (if the taxpayer is entitled to use this method) and the cost depletion method. If the cost depletion deduction is larger, the taxpayer must utilize that method for the taxable year in question.[34]

Limitation on oil and gas percentage depletion to independent producers and royalty owners

As stated above, percentage depletion of oil and gas properties generally is not permitted, except for independent producers and royalty owners, certain fixed-price gas contracts, and

[28] Secs. 611 - 613.

[29] Sec. 613.

[30] Sec. 613A(c).

[31] Sec. 613A(c)(1).

[32] Sec. 613(a). For marginal production, discussed *infra*, this limitation is suspended for taxable years beginning after December 31, 1997, and before January 1, 2008 and for taxable years beginning after December 31, 2008 and before January 1, 2010.

[33] Sec. 613A(d)(1).

[34] Sec. 613(a).

natural gas from geopressured brine. For purposes of the percentage depletion allowance, an independent producer is any producer that is not a "retailer" or "refiner." A retailer is any person that directly, or through a related person, sells oil or natural gas (or a derivative thereof): (1) through any retail outlet operated by the taxpayer or related person, or (2) to any person that is obligated to market or distribute such oil or natural gas (or a derivative thereof) under the name of the taxpayer or the related person, or that has the authority to occupy any retail outlet owned by the taxpayer or a related person.[35]

Bulk sales of crude oil and natural gas to commercial or industrial users, and bulk sales of aviation fuel to the Department of Defense, are not treated as retail sales. Further, if the combined gross receipts of the taxpayer and all related persons from the retail sale of oil, natural gas, or any product derived therefrom do not exceed $5 million for the taxable year, the taxpayer will not be treated as a retailer.

A refiner is any person that directly or through a related person engages in the refining of crude oil in excess of an average daily refinery run of 75,000 barrels during the taxable year.[36]

Percentage depletion for eligible taxpayers is allowed for up to 1,000 barrels of average daily production of domestic crude oil or an equivalent amount of domestic natural gas.[37] For producers of both oil and natural gas, this limitation applies on a combined basis. All production owned by businesses under common control and members of the same family must be aggregated;[38] each group is then treated as one producer in applying the 1,000-barrel limitation.

In addition to independent producers and royalty owners, certain sales of natural gas under a fixed contract in effect on February 1, 1975, and certain natural gas from geopressured brine, are eligible for percentage depletion, at rates of 22 percent and 10 percent, respectively. These exceptions apply without regard to the 1,000-barrel-per-day limitation and regardless of whether the producer is an independent producer or an integrated oil company.

Prior to the enactment of the Omnibus Budget Reconciliation Act of 1990 (the "1990 Act"), if an interest in a proven oil or gas property was transferred (subject to certain exceptions), the production from such interest did not qualify for percentage depletion.[39] The 1990 Act repealed the limitation on claiming percentage depletion on transferred properties effective for property transfers occurring after October 11, 1990.

---

[35] Sec. 613A(d)(2).

[36] Sec. 613A(d)(4).

[37] Sec. 613A(c).

[38] Sec. 613A(c)(8).

[39] Pub. L. No. 101-508.

Percentage depletion on marginal production

The 1990 Act also created a special percentage depletion provision for oil and gas production from so-called marginal properties held by independent producers or royalty owners.[40] Under this provision, the statutory percentage depletion rate is increased (from the general rate of 15 percent) by one percent for each whole dollar that the average price of crude oil for the immediately preceding calendar year is less than $20 per barrel. In no event may the rate of percentage depletion under this provision exceed 25 percent for any taxable year. The increased rate applies for the taxpayer's taxable year that immediately follows a calendar year for which the average crude oil price falls below the $20 floor. To illustrate the application of this provision, the average price of a barrel of crude oil for calendar year 1999 was $15.56. Thus, the percentage depletion rate for production from marginal wells was increased to 19 percent for taxable years beginning in 2000. Since the price of oil currently is above the $20 floor, there is no increase in the statutory depletion rate for marginal production.

The Code defines the term "marginal production" for this purpose as domestic crude oil or domestic natural gas which is produced during any taxable year from a property which (1) is a stripper well property for the calendar year in which the taxable year begins, or (2) is a property substantially all of the production from which during such calendar year is heavy oil (i.e., oil that has a weighted average gravity of 20 degrees API or less, corrected to 60 degrees Fahrenheit).[41] A stripper well property is any oil or gas property that produces a daily average of 15 or fewer equivalent barrels of oil and gas per producing oil or gas well on such property in the calendar year during which the taxpayer's taxable year begins.[42]

The determination of whether a property qualifies as a stripper well property is made separately for each calendar year. The fact that a property is or is not a stripper well property for one year does not affect the determination of the status of that property for a subsequent year. Further, a taxpayer makes the stripper well property determination for each separate property interest (as defined under section 614) held by the taxpayer during a calendar year. The determination is based on the total amount of production from all producing wells that are treated as part of the same property interest of the taxpayer. A property qualifies as a stripper well property for a calendar year only if the wells on such property were producing during that period at their maximum efficient rate of flow.

If a taxpayer's property consists of a partial interest in one or more oil- or gas-producing wells, the determination of whether the property is a stripper well property or a heavy oil property is made with respect to total production from such wells, including the portion of total production attributable to ownership interests other than the taxpayer's interest. If the property satisfies the requirements of a stripper well property, then the benefits of this provision apply with respect to the taxpayer's allocable share of the production from the property. The deduction

[40] Sec. 613A(c)(6).

[41] Sec. 613A(c)(6)(D).

[42] Sec. 613A(c)(6)(E).

is allowed for the taxable year that begins during the calendar year in which the property so qualifies.

The allowance for percentage depletion on production from marginal oil and gas properties is subject to the 1,000-barrel-per-day limitation discussed above. Unless a taxpayer elects otherwise, marginal production is given priority over other production for purposes of utilization of that limitation.

G. Deduction for Income Attributable to Domestic Production of Oil and Gas (sec. 199)

Section 199 of the Code provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to a portion of the lesser of a taxpayer's taxable income or its qualified production activities income.[43] In general, for taxable years beginning after 2009, the deduction is nine percent of such income. With respect to a taxpayer that has oil related qualified production activities income for taxable years beginning after 2009, the deduction is limited to six percent of the least of its oil related production activities income, its qualified production activities income, or its taxable income.[44]

A taxpayer's deduction under section 199 for a taxable year may not exceed 50 percent of the wages properly allocable to domestic production gross receipts paid by the taxpayer during the calendar year that ends in such taxable year.[45]

---

[43] In the case of an individual, the deduction is equal to a portion of the lesser of the taxpayer's adjusted gross income or its qualified production activities income. For this purposes, adjusted gross income is determined after application of sections 86, 135, 137, 219, 221, 222, and 469, and without regard to the section 199 deduction.

[44] "Oil related qualified production activities income" means the qualified production activities income attributable to the production, refining, processing, transportation, or distribution of oil, gas or any primary product thereof (as defined in section 927(a)(2)(C) prior to its repeal). Treas. Reg. sec. 1.927(a)-1T(g)(2)(i) defines the term "primary product from oil" to mean crude oil and all products derived from the destructive distillation of crude oil, including volatile products, light oils such as motor fuel and kerosene, distillates such as naphtha, lubricating oils, greases and waxes, and residues such as fuel oil. Additionally, a product or commodity derived from shale oil which would be a primary product from oil if derived from crude oil is considered a primary product from oil. Treas. Reg. sec. 1.927(a)-1T(g)(2)(ii) defines the term "primary product from gas" as all gas and associated hydrocarbon components from gas wells or oil wells, whether recovered at the lease or upon further processing, including natural gas, condensates, liquefied petroleum gases such as ethane, propane, and butane, and liquid products such as natural gasoline. Treas. Reg. sec. 1.927(a)-1T(g)(2)(iii) provides that these primary products and processes are not intended to represent either the only primary products from oil or gas or the only processes from which primary products may be derived under existing and future technologies. Treas. Reg. sec. 1.927(a)-1T(g)(2)(iv) provides as examples of non-primary oil and gas products petrochemicals, medicinal products, insecticides, and alcohols.

[45] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. Elective deferrals include elective deferrals as defined in section 402(g)(3), amounts deferred under section 457, and, for taxable years beginning after December 31, 2005, designated Roth contributions (as defined in section 402A).

Qualified production activities income

In general, "qualified production activities income" is equal to domestic production gross receipts (defined by section 199(c)(4)), reduced by the sum of: (1) the costs of goods sold that are allocable to such receipts; and (2) other expenses, losses, or deductions which are properly allocable to such receipts.

Domestic production gross receipts

"Domestic production gross receipts" generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange or other disposition, or any lease, rental or license, of qualifying production property ("QPP") that was manufactured, produced, grown or extracted ("MPGE") by the taxpayer in whole or in significant part within the United States;[46] (2) any sale, exchange or other disposition, or any lease, rental or license, of qualified film produced by the taxpayer; (3) any sale, exchange or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction activities performed in the United States;[47] or (5) engineering or architectural services performed in the United States with respect to the construction of real property in the United States.

Drilling oil or gas wells

The Treasury regulations provide that qualifying construction activities performed in the United States include activities relating to drilling an oil or gas well.[48] Under the regulations, activities the cost of which are intangible drilling and development costs within the meaning of Treas. Reg. sec. 1.612-4 are considered to be activities constituting construction for purposes of determining domestic production gross receipts.[49]

Qualifying in-kind partnerships

In general, an owner of a pass-through entity is not treated as conducting the qualified production activities of the pass-thru entity, and vice versa. However, the Treasury regulations provide a special rule for "qualifying in-kind partnerships," which are defined as partnerships engaged solely in the extraction, refining, or processing of oil, natural gas, petrochemicals, or

[46] Domestic production gross receipts include gross receipts of a taxpayer derived from any sale, exchange or other disposition of agricultural products with respect to which the taxpayer performs storage, handling or other processing activities (other than transportation activities) within the United States, provided such products are consumed in connection with, or incorporated into, the manufacturing, production, growth or extraction of qualifying production property (whether or not by the taxpayer).

[47] For this purpose, construction activities include activities that are directly related to the erection or substantial renovation of residential and commercial buildings and infrastructure. Substantial renovation would include structural improvements, but not mere cosmetic changes, such as painting, that is not performed in connection with activities that otherwise constitute substantial renovation.

[48] Treas. Reg. sec. 1.199-3(m)(1)(i).

[49] Treas. Reg. sec. 1.199-3(m)(2)(iii).

products derived from oil, natural gas, or petrochemicals in whole or in significant part within the United States, or the production or generation of electricity in the United States.[50] In the case of a qualifying in-kind partnership, each partner is treated as having MPGE property to the extent such property is distributed by the partnership to that partner.[51] If a partner of a qualifying in-kind partnership derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of the property that was MPGE by the qualifying in-kind partnership, then, provided such partner is a partner of the qualifying in-kind partnership at the time the partner disposes of the property, the partner is treated as conducting the MPGE activities previously conducted by the qualifying in-kind partnership with respect to that property.[52]

Alternative minimum tax

The deduction for domestic production activities is allowed for purposes of computing AMTI (including adjusted current earnings). The deduction in computing AMTI is determined by reference to the lesser of the qualified production activities income (as determined for the regular tax) or the AMTI (in the case of an individual, adjusted gross income as determined for the regular tax) without regard to this deduction.

H. Exception from Passive Loss Rules for Working Interests in Oil and Gas Property (sec. 469)

The passive loss rules limit deductions and credits from passive trade or business activities.[53] A passive activity for this purpose is a trade or business activity in which the taxpayer owns an interest, but in which the taxpayer does not materially participate. A taxpayer is treated as materially participating in an activity only if the taxpayer is involved in the operation of the activity on a basis that is regular, continuous, and substantial.[54] Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. Deductions and credits that are suspended under these rules are carried forward and treated as deductions and credits from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of his entire interest in the passive activity to an unrelated person.

[50] Treas. Reg. sec. 1.199-9(i)(2).

[51] Treas. Reg. sec. 1.199-9(i)(1).

[52] *Ibid.*

[53] Sec. 469. These rules were enacted in 1986 to curtail tax shelters. They apply to individuals, estates and trusts, and closely held corporations.

[54] Regulations provide more detailed standards for material participation. See Treas. Reg. sec. 1.469-5 and -5T.

Losses from certain working interests in oil and gas property are not limited under the passive loss rule.[55] Thus, losses and credits from such interests can be used to offset other income of the taxpayer without limitation under the passive loss rule. Specifically, a passive activity does not include a working interest in any oil or gas property that the taxpayer holds directly or through an entity that does not limit the liability of the taxpayer with respect to the interest. This rule applies without regard to whether the taxpayer materially participates in the activity. If the taxpayer has a loss from a working interest in any oil or gas property that is treated as not from a passive activity, then net income from the property for any succeeding taxable year is treated as income of the taxpayer that is not from a passive activity.

In general, a working interest is an interest with respect to an oil and gas property that is burdened with the cost of development and operation of the property. Rights to overriding royalties, production payments, and the like, do not constitute working interests, because they are not burdened with the responsibility to share expenses of drilling, completing, or operating oil and gas property. Similarly, contract rights to extract or share in oil and gas, or in profits from extraction, without liability to share in the costs of production, do not constitute working interests. Income from such interests generally is considered to be portfolio income.

When the taxpayer's form of ownership limits the liability of the taxpayer, the interest possessed by such taxpayer is not a working interest for purposes of the passive loss provision. Thus, for purposes of the passive loss rules, an interest owned by a limited partnership is not treated as a working interest with regard to any limited partner, and an interest owned by an S corporation is not treated as a working interest with regard to any shareholder. The same result follows with respect to any form of ownership that is substantially equivalent in its effect on liability to a limited partnership interest or interest in an S corporation, even if different in form.

When an interest is not treated as a working interest because the taxpayer's form of ownership limits his liability, the general rules regarding material participation apply to determine whether the interest is treated as a passive activity. Thus, for example, a limited partner's interest generally is treated as in a passive activity. In the case of a shareholder in an S corporation, the general facts and circumstances test for material participation applies and the working interest exception does not apply, because the form of ownership limits the taxpayer's liability.

A special rule applies in any case where, for a prior taxable year, net losses from a working interest in a property were treated by the taxpayer as not from a passive activity. In such a case, any net income realized by the taxpayer from the property (or from any substituted basis property, e.g., property acquired in a sec. 1031 like kind exchange for such property) in a subsequent year also is treated as active. Under this rule, for example, if a taxpayer claims losses for a year with regard to a working interest and then, after the property to which the interest relates begins to generate net income, transfers the interest to an S corporation in which he is a shareholder, or to a partnership in which he has an interest as a limited partner, his interest with regard to the property continues to be treated as not passive.

---

[55] Sec. 469(c)(3). See also Treas. Reg. sec. 1.469-1T(e)(4).

II. RULES OF GENERAL APPLICATION IMPORTANT TO THE OIL AND GAS INDUSTRY

A. Dual-Capacity Taxpayers

In general

The United States taxes its citizens and residents (including U.S. corporations) on their worldwide income. Because the countries in which income is earned also may assert their jurisdiction to tax the same income on the basis of source, foreign-source income earned by U.S. persons may be subject to double taxation. To mitigate this possibility, the United States generally provides a credit against U.S. tax liability for foreign income taxes paid or accrued.[56]

A foreign tax credit is available only for foreign income, war profits, and excess profits taxes, and for certain taxes imposed in lieu of such taxes. Other foreign levies generally are treated as deductible expenses. Treasury regulations under section 901 provide detailed rules for determining whether a foreign levy is a creditable income tax. In general, a foreign levy is considered a creditable tax if it is substantially equivalent to an income tax under U.S. tax principles. Under the present Treasury regulations, a foreign levy is considered a tax if it is a compulsory payment under the authority of a foreign country to levy taxes and is not compensation for a specific economic benefit provided by a foreign country.[57]

Dual-capacity taxpayers

A taxpayer that is subject to a foreign levy and also receives a specific economic benefit from the foreign country is considered a "dual-capacity taxpayer."[58] A "specific economic benefit" is broadly defined as an economic benefit that is not made available on substantially the same terms to substantially all persons who are subject to the income tax that is generally imposed by the foreign country, or, if there is no such generally imposed income tax, an economic benefit that is not made available on substantially the same terms to the population of the country in general.[59] An example of a specific economic benefit includes a concession to extract government-owned petroleum. Other examples of economic benefits that may be specific if not provided on substantially the same terms to the population in general, include property; a service; a fee or other payment; a right to use, acquire or extract resources, patents, or other property that a foreign country owns or controls (as defined within the regulations); or a reduction or discharge of a contractual obligation.

Treasury regulations addressing payments made by dual-capacity taxpayers were developed in response to the concern that payments which purported to be income taxes imposed

---

[56] Sec. 901.

[57] Treas. Reg. sec. 1.901-2(a)(2)(i).

[58] Treas. Reg. sec. 1.901-2(a)(ii).

[59] Treas. Reg. sec. 1.901-2(a)(2)(ii)(B).

on U.S. oil companies by mineral-owning foreign governments were at least partially, in substance, royalties or some other business expense.[60] To the extent that a taxpayer meets the definition of a dual-capacity taxpayer, the taxpayer may not claim a foreign tax credit for the portion of the foreign levy that is paid for the specific economic benefit.[61] Treasury regulations require that a dual-capacity taxpayer, similar to other taxpayers, must establish that the foreign levy meets the requirements of section 901 or section 903.[62] However, the regulations require that a dual-capacity taxpayer use either a facts and circumstances method or a safe harbor method in establishing the foreign levy is an income tax.[63]

Under the facts and circumstances method, a separate levy is creditable to the extent that the taxpayer establishes, based on all the relevant facts and circumstances, the amount of the levy that is not paid as compensation for the specific economic benefit.[64] For purposes of applying the facts and circumstances method, the foreign country need not have a generally imposed income tax.

A dual-capacity taxpayer alternatively may choose to apply the safe harbor method on a country-by-country basis to determine whether a levy is a creditable tax.[65] Under the safe harbor method, if the foreign country has a generally imposed income tax, the taxpayer may credit the portion of the levy that application of the generally imposed income tax would yield provided that the levy otherwise constitutes an income tax or an in lieu of tax. The balance of the levy is treated as compensation for the specific economic benefit.[66] If the foreign country does not generally impose an income tax, the portion of the payment that does not exceed the applicable U.S. Federal tax rate, applied to net income, is treated as a creditable tax.[67] In general, a foreign tax is treated as generally imposed for this purpose even if it applies only to persons who are not residents or nationals of that country.[68]

---

[60] Testimony of Treasury Secretary Schultz, Hearings on "Windfall" Excess Profits Tax before the House Committee on Ways and Means, 93rd Cong., 2d Sess. 151 (1974).

[61] Treas. Reg. sec. 1.901-2A(a)(1). The payment may be deductible, however, as an ordinary and necessary business expense.

[62] Treas. Reg. sec. 1.901-2A(b)(1).

[63] Treas. Reg. sec. 1.901-2A(c).

[64] Treas. Reg. sec. 1.901-2A(c)(2).

[65] A taxpayer may make an election to use the safe harbor method with respect to one or more foreign states. The election applies to the year of the election and to all subsequent taxable years unless revoked. The election is made by the common parent and applies to all members of the affiliated group. See Treas. Reg. sec. 1.902-2A(d).

[66] Treas. Reg. sec. 1.901-2A(d) and (e). Detailed rules are provided for determining the amount that imposition of the generally applicable tax to the dual-capacity taxpayer would yield, based on the taxpayer's gross receipts, costs and expenses, and other factors.

[67] Treas. Reg. sec. 1.901-2A(e)(5).

[68] See Treas. Reg. sec. 1.903-1(b)(3), Ex. 4.

After the promulgation of the regulations, many dual-capacity taxpayers elected the safe harbor method for determining what portion, if any, of the separate foreign levy they paid would be treated as a creditable income tax. However, in 1999, the Tax Court in *Exxon Corp. v. Commissioner* determined that the entire amount of the petroleum revenue tax paid by Exxon to the U.K. government did not constitute compensation for a specific economic benefit and would thus qualify as tax for purposes of the foreign tax credit.[69] The Court considered that Exxon entered into an arm's length licensing agreement with the U.K. government to gain access to the North Sea oil fields prior to the enactment of the petroleum revenue tax, and determined that Exxon's right to explore, develop and exploit petroleum resources was dependent on the licensing agreement and payment of license fees under that agreement and not in exchange for payment of the tax. Subsequent to the decision in *Exxon*, anecdotal evidence suggests that a significant number of dual-capacity taxpayers revoked their safe harbor elections and adopted the facts and circumstances method to argue for tax treatment for the entire amount of the qualifying levy.

Limitation on the use of foreign tax credits

The foreign tax credit generally is limited to a taxpayer's U.S. tax liability on its foreign-source taxable income (as determined under U.S. tax accounting principles). This limit is intended to ensure that the credit serves its purpose of mitigating double taxation of foreign-source income without offsetting U.S. tax on U.S.-source income.[70] The limit is computed by multiplying a taxpayer's total U.S. tax liability for the year by the ratio of the taxpayer's foreign-source taxable income for the year to the taxpayer's total taxable income for the year. If the total amount of foreign income taxes paid and deemed paid for the year exceeds the taxpayer's foreign tax credit limitation for the year, the taxpayer may carry back the excess foreign taxes to the immediately preceding taxable year or carry forward the excess taxes forward 10 years.[71]

In addition, this limitation is calculated separately for various categories of income, generally referred to as "separate limitation categories." The total amount of foreign taxes attributable to income in a separate limitation category that may be claimed as credits may not exceed the proportion of the taxpayer's total U.S. tax liability which the taxpayer's foreign-source taxable income in that separate limitation category bears to the taxpayer's worldwide taxable income. The separate limitation rules are intended to reduce the extent to which excess foreign taxes paid in a high-tax foreign jurisdiction can be "cross-credited" against the residual U.S. tax on low-taxed foreign-source income.[72]

---

[69] *Exxon v. Commissioner*, 113 T.C. 338 (1999) (hereinafter "*Exxon v. Commissioner*"). See also *Philips Petroleum Co. v. Commissioner*, 104 T.C. 256 (1995).

[70] Secs. 901 and 904.

[71] Sec. 904(c).

[72] Sec. 904(d). For taxable years beginning prior to January 1, 2007, section 904(d) generally provides eight separate limitation categories (or "baskets") and effectively many more in situations in which various special rules apply. The American Jobs Creation Act of 2004 reduced the number of baskets from nine to eight for taxable

Special rule for foreign oil and gas income

A special limitation applies with respect to taxes on combined foreign oil and gas income applied prior to the foreign tax credit limitation discussed above.[73] This limitation was adopted prior to the issuance of the regulations providing the rules discussed above for dual-capacity taxpayers and was intended to address the concern that payments made by oil companies to many oil-producing nations were royalties disguised as tax payments.[74] Additionally, the limitation sought to prevent the crediting of high foreign taxes on foreign oil and gas income against the residual U.S. tax on other types of lower-taxed foreign source income.[75]

Under this special limitation, amounts claimed as taxes paid on combined foreign oil and gas income are creditable in a given taxable year (if they otherwise qualify as creditable taxes) only to the extent they do not exceed the applicable U.S. tax on that income. The applicable U.S. tax is determined for a corporation as the product of the amount of such combined foreign oil and gas income for the taxable year and the highest marginal tax rate for corporations.[76] Any excess foreign taxes may be carried back to the immediately preceding taxable year and carried forward 10 taxable years and credited (not deducted) to the extent that the taxpayer otherwise has excess limitation with regard to combined foreign oil and gas income in a carryover year.[77] Amounts that are not limited under section 907 (relating to combined foreign oil and gas income discussed above) are included in the general basket or passive basket (as applicable) for purposes of applying the section 904 limitation.

---

years beginning after December 31, 2002, and further reduced the number of baskets to two (i.e., "general" and "passive") for taxable years beginning after December 31, 2006. Pub. L. No. 108-357, sec. 404 (2004).

[73] Sec. 907. For taxable years beginning before January 1, 2009, the components of what is now defined as combined foreign oil and gas income included foreign oil and gas extraction income ("FOGEI") and foreign oil related income ("FORI"). Under the prior rules, FOGEI and FORI were subject to separate limitations under section 907. Pub. L. No 110-343, Sec. 402(a). Amounts claimed as taxes paid on FOGEI of a U.S. corporation qualified as creditable taxes (if they otherwise so qualified), if they did not exceed the product of FOGEI multiplied by the highest marginal U.S. tax rate on corporations. A separate limitation was deemed to apply to FORI which theoretically applied in certain cases where the foreign law imposing such amount of tax is structured, or in fact operated, so that the amount of tax imposed with respect to FORI generally was "materially greater," over a "reasonable period of time," than the amount generally imposed on income that was neither FORI nor FOGEI. Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 110th Congress*, (JCS-1-09), March 2009, at 358.

[74] Joint Committee on Taxation, *General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982*, (JCS-38-82), December 31, 1982, sec. IV.A.7.a, fn 63.

[75] H.R. Conf. Rept. No. 103-213, at 646 (1993).

[76] Sec. 907(a). For an individual, the limitation is the product of the amount of such combined foreign oil and gas income for the taxable year and a fraction, the numerator of which is the tax against which the credit under section 901(a) is taken and the denominator of which is the taxpayer's entire taxable income.

[77] Sec. 907(f).

B. Last-In, First-Out Inventory Accounting Method

In general

In general, for Federal income tax purposes, taxpayers must account for inventories if the production, purchase, or sale of merchandise is a material income-producing factor to the taxpayer.[78]

Under the last-in, first-out ("LIFO") method, it is assumed that the last items entered into the inventory are the first items sold. Because the most recently acquired or produced units are deemed to be sold first, cost of goods sold is valued at the most recent costs; the effect of cost fluctuations is reflected in the ending inventory, which is valued at the historical costs rather than the most recent costs.[79] Compared to first-in, first-out ("FIFO"), LIFO produces net income which more closely reflects the difference between sale proceeds and current market cost of inventory. When costs are rising, the LIFO method results in a higher measure of cost of goods sold and, consequently, a lower measure of income when compared to the FIFO method. The inflationary gain experienced by the business in its inventory is generally not reflected in income, but rather, remains in ending inventory as a deferred gain until a future period in which sales exceed purchases.[80]

Dollar-value LIFO

Under a variation of the LIFO method, known as dollar-value LIFO, inventory is measured not in terms of number of units but rather in terms of a dollar-value relative to a base cost. Dollar-value LIFO allows the "pooling" of dissimilar items into a single inventory calculation. Thus, depending upon the taxpayer's method for defining an item, LIFO can be applied to a taxpayer's entire inventory in a single calculation even if the inventory is made up of different physical items. For example, a single dollar-value LIFO calculation can be performed for an inventory that includes both yards of fabric and sewing needles. This effectively permits the deferral of inflationary gain to continue even as the inventory mix changes or certain goods previously included in inventory are discontinued by the business.

---

[78] Sec. 471(a) and Treas. Reg. sec. 1.471-1.

[79] Thus, in periods during which a taxpayer produces or purchases more goods than the taxpayer sells (an inventory increment), a LIFO method taxpayer generally records the inventory cost of such excess (and separately tracks such amount as the "LIFO layer" for such period), adds it to the cost of inventory at the beginning of the period, and carries the total inventory cost forward to the beginning inventory of the following year. Sec. 472(b).

[80] Accordingly, in periods during which the taxpayer sells more goods than the taxpayer produces or purchases (and inventory decrement), a LIFO method taxpayer generally determines the cost of goods sold of the amount of the decrement by treating such sales as occurring out of the most recent LIFO layer (or most recent LIFO layers, if the amount of the decrement exceeds the amount of inventory in the most recent LIFO layer) in reverse chronological order.

Simplified rules for certain small businesses

In 1986, Congress enacted a simplified dollar-value LIFO method for certain small businesses.[81] In doing so, the Congress acknowledged that the LIFO method is generally considered to be an advantageous method of accounting, and that the complexity and greater cost of compliance associated with LIFO, including dollar-value LIFO, discouraged smaller taxpayers from using LIFO.[82]

To qualify for the simplified method, a taxpayer must have average annual gross receipts of $5 million or less for the three preceding taxable years.[83] Under the simplified method, taxpayers are permitted to calculate inventory values by reference to changes in published price indexes rather than comparing actual costs to base period costs.

Special rules for qualified liquidations of LIFO inventories

In certain circumstances, reductions in inventory levels may be beyond the control of the taxpayer. Section 473 of the Code mitigates the adverse effects in certain specified cases by allowing a taxpayer to claim a refund of taxes paid on LIFO inventory profits resulting from the liquidation of LIFO inventories if the taxpayer purchases replacement inventory within a defined replacement period. The provision generally applies when a decrease in inventory is caused by reduced supply due to government regulation or supply interruptions due to the interruption of foreign trade.

[81] Sec. 474(a).

[82] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress; Public Law 99-514),* (JCS-10-87), May 4, 1987, p. 482.

[83] Sec. 474(c).

III. SELECTED PROPOSALS TO LIMIT OIL AND GAS TAX INCENTIVES

A. Description of the President's Proposal for Fiscal Year 2012

The proposal repeals (1) the enhanced oil recovery credit, (2) the marginal wells credit, (3) the expensing and 60-month amortization of IDCs, (4) the deduction for tertiary injectants,[84] (5) percentage depletion for oil and gas, (6) the domestic manufacturing deduction for income derived from the domestic production of oil and gas, (7) the exception for passive losses from working interests in oil and gas properties, and (8) the LIFO method of accounting. With respect to IDCs, the proposal requires that such costs be capitalized and recovered through depletion or depreciation, as applicable.

The proposal also increases the amortization period for G&G costs of independent and non-integrated producers from two to seven years. The seven-year amortization period would apply even if the property is abandoned such that any remaining unrecovered basis of the abandoned property would continue to be recovered over the remainder of the seven-year period.

Finally, the proposal modifies the dual-capacity taxpayer rules. In the case of a dual-capacity taxpayer, the proposal allows a taxpayer to treat as a creditable tax the portion of a foreign levy that does not exceed the foreign levy that the taxpayer would pay if it were not a dual-capacity taxpayer. The proposal replaces the current regulatory provisions, including the safe harbor, that apply to determine the amount of a foreign levy paid by a dual-capacity taxpayer that qualifies as a creditable tax. The proposal also converts the special foreign tax credit limitation rules of section 907 into a separate category within section 904 for foreign oil and gas income. The proposal yields to United States treaty obligations to the extent that they allow a credit for taxes paid or accrued on certain oil or gas income.

These proposal is generally effective for taxable years beginning after 2011 (amounts paid or incurred after 2011 for G&G costs).

B. Description of the Revenue Provisions in S. 940

The revenue provisions in S. 940 repeal for major integrated oil companies (1) the expensing and 60-month amortization of IDCs, (2) the deduction for tertiary injectants,[85] (3) percentage depletion for oil and gas, and (4) the domestic manufacturing deduction for income derived from the domestic production of oil and gas.

[84] If section 193 were repealed, the treatment of tertiary injectant expenses would revert to prior law and might include capitalization and recovery through depreciation, capitalization and recovery as consumed (e.g., as a supply), or deduction as loss in the year of abandonment or the year production benefits ceased. Amounts expensed as depreciation, depletion, or supplies may be subject to capitalization under section 263A. See, e.g., Treas. Reg. sec. 1.263A-1(e)(3).

[85] If section 193 were repealed, the treatment of tertiary injectant expenses would revert to prior law and might include capitalization and recovery through depreciation, capitalization and recovery as consumed (e.g., as a supply), or deduction as loss in the year of abandonment or the year production benefits ceased. Amounts expensed as depreciation, depletion, or supplies may be subject to capitalization under section 263A. See, e.g., Treas. Reg. sec. 1.263A-1(e)(3).

The proposal also modifies the dual capacity taxpayer rules. The modification proposed in S. 940 is the same as the President's budget proposal except that it applies only to major integrated oil companies and does not convert the special foreign tax credit limitation rules of section 907 into a separate category within section 904 for foreign oil and gas income.

C. Proposed Tax on Severance of Crude Oil and Natural Gas from the Outer Continental Shelf in the Gulf of Mexico

On June 19, 2007, the Senate Committee on Finance approved as part of its mark up of the "Energy Advancement and Investment Act of 2007," a proposal to add an excise tax on crude oil and natural gas produced from the outer continental shelf in the Gulf of Mexico.[86] Under current law, there is no Federal severance tax on oil and gas produced on the outer Continental Shelf (OCS). The United States leases Federal lands potentially containing oil and gas deposits from offshore or submerged lands under the Outer Continental Shelf Lands Act of 1953, as amended.[87] Many offshore oil and gas lessees are required to pay the United States a royalty of not less than 12.5 percent pursuant to the terms of their lease, which is sometimes paid in kind.[88] The royalty rate for most newly-issued OCS leases is 18 ¾ percent.[89]

The proposal establishes an excise tax equal to 13 percent of the removal price of any crude oil or natural gas produced from Federal submerged lands on the outer continental shelf in the Gulf of Mexico pursuant to a lease entered into with the United States that authorizes the production ("taxable crude oil or natural gas") during the taxable period. The tax is to be paid by the producer of the taxable crude oil or natural gas. For this purpose, crude oil includes condensates and natural gasoline. Under the proposal, each calendar year is a taxable period. The Secretary is to provide for the filing, and time for filing of the return of tax imposed under the proposal.

The removal price is defined as the amount for which the barrel of taxable crude oil (or dollars per thousand cubic feet in the case of natural gas) is sold by the taxpayer. In the case of sales between related parties, and crude oil or natural gas removed from the property before it is sold, the removal price is the constructive sales price. If the manufacture or conversion of crude oil into refined products begins before such oil is removed from the property, such oil is treated as removed on the day such manufacture or conversion begins, and the removal price is the

---

[86] See Joint Committee on Taxation, *Description of the Chairman's Modification to the Provisions of the "Energy Advancement and Investment Act of 2007,"* (JCX-33-07), June 18, 2007 at 34. The bill, including the severance tax provision, was approved by the Senate Committee on Finance by a vote of 15-5 and offered as Baucus Amendment No. 1704 to H.R. 6 (the "Energy Independence and Security Act of 2007") of the 110th Congress. However, the cloture vote in the Senate was not successful. The proposal can be found at section 885 of the amendment.

[87] 43 U.S.C. secs. 1335 and 1337.

[88] 43 U.S.C. secs. 1335, 1337 and 1353(a)(1).

[89] See, MMS Gulf of Mexico Lease Terms and Royalty Relief <http://www.boemre.gov/econ/PDFs/GOMLeaseTermsRRSummary.pdf>

constructive sales price. In determining the removal price of oil or natural gas from a property in the case of any transaction, the Secretary may adjust the removal price to reflect clearly the fair market value of oil or natural gas removed.

The proposal allows as a credit against the excise tax imposed by the proposal an amount equal to the aggregate amount of royalties paid under Federal law with respect to the production of taxable crude oil or natural gas produced from Federal submerged lands on the outer continental shelf in the Gulf of Mexico. In no event may the aggregate amount of the credit exceed the aggregate amount of tax imposed by the proposal in any calendar year.

The Secretary is authorized to prescribe such regulations and guidance as is necessary for the withholding and quarterly deposit of the tax imposed by the proposal, as well as other guidance as is necessary to carry out the proposal.

The proposal provides that the amount of the excise tax imposed, net of the credit for royalty payments, is deductible as a tax under section 164 of the Code.

Statement of Senator Tom A. Coburn, MD

Senate Committee on Finance
"Oil and Gas Tax Incentives and Rising Energy Prices"

May 12, 2011

Chairman Baucus, Vice-Chairman Hatch, I want to take this opportunity to express my concerns regarding both the subject matter and the methods of today's hearing entitled, "Oil and Gas Tax Incentives and Rising Energy Prices," in which representatives from the five major oil companies were brought to testify in front of Congress. Unfortunately, my schedule prevented me from attending the entire hearing.

Today millions of Americans are struggling with high energy costs, a problem sure to be heightened as we approach the busy summer driving season. As a first response, the Senate Finance Committee retrieved executives from the five major integrated oil and natural gas companies. Whether it was the intention of this Committee to hear witness testimony from executives as experts in the industry or as culprits by implication is unclear. What is clear is that the hearing failed to address the root of the problem: Congress. It has become clear that Congress plays a critical role in influencing the underlying factors built into energy prices. Unfortunately, this body continues to waste time pointing fingers at American businesses while failing to acknowledge its own role in contributing to the high price of oil and fuel at the pump.

The fundamental laws of supply and demand commonly thought to determine the price of fuel have been overshadowed by another factor, namely, the weak value of the U.S. dollar. Our country's national debt, which has now reached $14.3 trillion, along with historically low interest rates and slow economic growth has weakened the value of the dollar, causing investors holding other currencies to shift into dollar-priced commodities where their purchasing power is enhanced.[i]

Years of excessive congressional spending based on the parochial priorities of career politicians have debased our national currency and sent a signal to the international financial community that, as a country, we are not serious about addressing our mounting national debt.

Oil prices have risen over 20 percent since the beginning of 2011. The largest component of fuel pricing—crude oil—rises and falls, largely in accordance (and inversely) with the value of the dollar.

The dollar, for its part, corresponds with the spending habits of Congress. Excessive congressional spending has led to annual billion dollar deficits since 2001. Since 2009, Congress has exceeded *trillion* dollar deficits.[ii] The President's FY 2012 budget creates a $1.101 trillion deficit. According to CBO, we will add an additional $3.4 trillion to the national debt in the next three years (FY2011-FY2013). The cost (interest) of borrowing just this $3.4 trillion will be $1.4 trillion over the next ten years.[iii] This means Congress borrows $0.40 cents for every dollar it spends.

Not surprisingly, the U.S. dollar recently hit a three-year low against a basket of six major currencies without much hope for change as the Federal Reserve continues Quantitative Easing policies and resists raising interest rates.[iv] Federal Reserve Chairman Ben Bernanke's recent press conference signaled no change in this loose monetary policy, which only served to further weaken the dollar's prospects of gaining.

The failure of Congress to establish a stable economic environment by making difficult budgeting choices has led Standard & Poor's to downgrade its outlook for the United States' triple-A sovereign rating from "stable" to "negative," stating there is a one in three chance our country could give up its current investment rating within two years after it is expected to run a $1.5 trillion deficit this year—the third consecutive year the deficit will exceed $1 trillion.[v]

As *The Economist* recently pointed out, "Credit-rating agencies are notorious for announcing with great fanfare what has been obvious to financial markets for months."[vi] It is no surprise investors are shifting to dollar-priced commodities while foreign currencies yield extraordinary buying power.

The weak value of the dollar is a direct result of the incompetency of Congress—its insatiable desire to spend taxpayer dollars without finding ways to pay. The years of excess are not exclusive or limited to energy; rather, they span the entire federal government. The incompetency of Congress in failing to budget within its means and according to the priorities of Americans has led our country into the position it is in today.

Clearly our nation faces a critical crossroads that has forced Congress to re-evaluate the federal government's numerous financial liabilities in their entirety. Congress can directly address rising oil prices by reducing federal spending. I supported the recommendations of the President's National Commission for Fiscal Responsibility and Reform, which addressed energy tax advantages, because our priority must be to push the debate forward regarding ways to curb Washington's unbridled spending.

The ultimate goal of eliminating tax expenditures and other subsidies should be to transition the allocation of capital from Washington back into markets by leveling the tax code in a comprehensive manner without bias towards fuel choices. Doing so would return American enterprise to a true free market and the competitive environment necessary to achieve greater production levels and the more efficient allocation of resources.

Given the resources and broad jurisdiction of this Committee, I would suggest a more productive approach would be to broaden this review to include a thorough and equitable analysis of all energy preferences in the tax code. Rather than revealing the underlying biases and political preferences of the Majority, this Committee should undertake an honest examination of the entire tax code. If it does, it will learn that it spends (and loses) far more on renewable resources than it does on oil and natural gas. According to the Congressional Research Service, total federal revenue losses in 2010 associated with fossil fuels is $2.4 billion. Estimated revenue losses and outlays associated with renewable energies totaled $13 billion, of which $6.3 billion is attributable to tax provisions. Further, $2.1 billion goes towards energy efficiency initiatives, $800 million towards alternative technology vehicles.[vii]

Our experience with federal ethanol subsidies would show it is less than prudent to subsidize emerging technologies, because the artificial success they achieve often fall away when the subsidies are removed.

According to the International Energy Agency (IEA), an organization known for opposing incentives for the production and consumption of fossil fuels, "The United States offers little in the way of fossil fuel subsidies, compared to other nations...The Administration should focus on making the U.S. more competitive for corporate activities instead of targeting energy firms for punitive tax treatment."[viii]

Moreover, if Congress wants to eliminate business expensing from the oil and natural gas industry, it must do so economy-wide. The very fact that industries across our entire economy are allowed to expense capital costs and other expenses is indicative of our outdated tax code. When everyone gets a distortion—whether unique to a particular industry or common across them all—corporate tax rates are clearly not achieving their intended goals. To single out one industry is yet another example of politicians picking winners and losers—*losers,* in this case. Among those of us with actual business experience, there is no appetite for needlessly crippling the competitiveness of American companies big or small.

If Congress is bent towards generating more revenue to address its debt rather than reducing excessive, wasteful, and duplicating spending, it should first increase access to America's natural resources. The United States is the only country in the world that insists its citizens do not own the rights to its natural resources, ultimately laying claim as a government collectively than acting as a non-biased conduit for competitive bidding. Congress would be wise to remember that rents, royalties, and income taxes paid by the oil and natural gas industry provide one of the largest sources of federal revenue outside of income taxes.[ix]

As it stands, Congress is one of the greatest barriers to further traditional and alternative energy development. The federal government already owns 650 million acres—approximately 30 percent of the entire land area in our country or nearly one in three acres nationwide, and one out of every two in the West. Moreover, only 8 percent of onshore federal oil and 10 percent of onshore natural gas is currently accessible under standard leasing due to Congress and federal agencies prohibiting American energy companies from accessing them.[x] At the same time, the Congressional Research Service has pointed out that our nation holds the largest supply of energy (combined oil, natural gas, and coal) in the world.[xi]

Acting on the assumption that our domestic natural resources belong to the government rather than to those seeking to access, Congress and unchecked federal agencies continue to impose regulatory hurdles and permitting delays originating in Washington, DC, that add costs to companies seeking to explore for and developed untapped resources.

Permit approval from the Bureau of Land Management takes 200 to 500 days. On top of this, fees for applications of permits not only exist but have recently increased. There are currently over 90 offshore leasing plans pending at the Bureau of Ocean Energy Management, Regulation,

and Enforcement and (BOEMRE). Too often, companies are left with high processing costs, delays, and uncertainties for the timely approval of their operations.

The difficulties are not limited to oil and natural gas. The U.S. House of Representatives recently held a hearing on the topic, and USA Today reported:

"The Obama administration claims solar-energy production is one of its highest priorities, yet only a tiny fraction of public land is even being considered for this use, and almost nothing has actually been made available," Republican Rep. Doug Lamborn of Colorado, chairman of the panel's Energy and Minerals Subcommittee, said during a hearing before the full committee.

Lamborn said the Bureau of Land Management has reserved less than 1 percent of its Western land for so-called "solar energy zones," where projects can be approved faster.

BLM director Bob Abbey acknowledged the renewable energy potential of public lands hasn't been met.[xii]

Consequently, the cost of doing business in the United States has grown exponentially due to overregulation, and businesses across all industries are struggling just to keep up. In fact, over the last two years, the federal government issued an average of 66 major regulations per year, approximately 40 percent higher than the averages per year by Presidents Bush and Clinton.[xiii] Congress has completely failed in its oversight responsibilities to ensure federal agencies are functioning within their appropriate roles and American businesses, energy companies particular, have suffered as a result.

To make matters worse, our nation is significantly leveraged as we are importing approximately 50 percent of our nation's crude oil consumption.[xiv] Naturally, among other things, this subjects American consumers to the volatility that can occur in foreign countries. For example, after the initial conflict in Libya earlier this year—the source of only 2 percent of global supply[xv]—the price of crude rose by $12 dollars overnight and continued to rise to $15.[xvi] To counter U.S. exposure to the volatility of global market disruptions or political instability overseas suppliers, the U.S. government must increase access to our extensive domestic natural resources to send appropriate price signals internationally.

I would also offer a counter to the notion that oil and natural gas companies are not paying their fair share in taxes. Recent media reports have exposed some of America's largest corporations for escaping the current 35 percent corporate tax rate, so it is understandable that some would question whether oil and gas companies are paying their fair share. In reality, energy companies are paying more, relative to other industries, and in fact face prohibitive effective tax rates. However, any assumption that profitability merits increased taxation or restrictions on growth starkly contradicts the foundation of our free market economy.

According to data compiled by *Compustat North America*, the oil and gas industry maintains a 41 percent effective tax rate compared to 26.5 percent for other S&P companies in 2010. Additionally, oil companies pay rents, royalties, and lease payments totaling more than $100 billion annually.[xvii]

Integrated oil companies are large, complex businesses that operate large-scale, capital-intensive projects. Naturally, the cash flows circulating through these companies' balance sheets are astronomical. There are three points to remember though: (1) these numbers are not *net* profits, (2) company executives are not the sole beneficiaries of the net profits, and (3) revenues do not come at the expense of consumers—companies maintain relatively high revenues in times of high and low oil prices.

To assume, for example, that "Big Oil CEOs" keep the lion's share of earnings is wildly false. Nearly 70 percent of oil and gas shares are held by institutional investors—holders of mutual fund shares or participants in pension funds or other retirement accounts.[xviii] According to a 2007 SONECON, LLC study—an economic advisory firm—shareholders of oil companies are broken down as follows: Mutual Funds (29.5 percent), Pension Funds (27 percent), Individual Investors (23 percent), IRAs (14 percent), Other Institutions (5 percent), and Corporate Executives (1.5 percent).[xix]

Finally, re-investments into new projects and technology often nearly match revenues. Eighty-five (85) percent of revenue that would be raised by repealing provisions examined by this Committee would be reinvested into capital-intensive domestic oil and gas projects. Frankly, given Congress' historic failure to prioritize its own spending in an efficient and effective fashion, it lacks credibility on the issue.

Considering the aforementioned components of this debate, Congress should begin its efforts to address our entire outdated tax code, which is complex, layered and riddled with inefficiencies and inequalities that suppress or misdirect capital formation and hamstring businesses and individuals from growing our economy. Indeed, over 15,000 changes in layers have been made since the Tax Reform Act of 1986 attempted to simplify the tax code, as noted by this Committee in an earlier discussion of the tax code. Today there are over $1 trillion in tax expenditures in statute.

Our first priority must be to eliminate the billions of dollars in wasteful, excessive, and unconstitutional spending initiatives. Take for instance the Volumetric Ethanol Excise Tax Credit (VEETC)—a true oil and gas subsidy—that companies receive to blend ethanol with gasoline despite a federal mandate that requires them to do so anyway. This tax credit costs taxpayers approximately $6 billion annually and $24 billion since its inception in 2005. If left intact through 2011, it is estimated to cost taxpayers $30 billion over its lifetime, which is more than would be saved by repealing what the President has proposed over five years ($18.54 billion).

This hearing was indeed a "dog-and-pony show" over the price of gasoline—a familiar problem and a fixable one if Congress would curb its spending appetite and remove restrictions on our domestic natural resources. I would further add that I was disappointed with the tactics used by some of my colleagues at the hearing who used their positions to point fingers with elementary accusations that play well in the media but lack standing in the policy arena. Such gestures are not supported by substance, especially considering some Members did not allow witnesses to fully respond before yielding to the next interrogator.

Clearly, this hearing was simply a political stunt as an effort to take advantage of high gas prices. This hearing—and the solutions suggested during the course of it—will not make gas prices less expensive or this nation any less dependent on foreign sources of oil. It certainly does nothing to increase access to more energy reserves or address the role of speculation. Not once did Members of the Committee make a valid connection between oil and gas tax incentives and rising gas prices, as the hearing's title would suggest.

As a new member of this Committee, it is my sincere hope that my colleagues will not make a habit of making political charades of real problems and further squander the time remaining before imminent consequences of our debt crisis materialize.

---

[i] http://www.fxstreet.com/technical/market-view/weekly-forex-and-related-markets-commentary/2011/05/04/
[ii] http://www.whitehouse.gov/omb/budget/Historicals/
[iii] Table 1.1—Summary of Receipts, Outlays, and Surpluses or Deficits (-): 1789–2016 and Table 7.1—Federal Debt at the End of Year: 1940–2016
[iv] http://www.fxstreet.com/technical/market-view/weekly-forex-and-related-markets-commentary/2011/05/04/
[v] http://www.usnews.com/news/articles/2011/04/18/sp-downgrades-outlook-on-national-debt
[vi] http://www.economist.com/node/18586668
[vii] CRS Memo, Molly Sherlock, May 2011
[viii] http://www.taxfoundation.org/news/show/26851.html
[ix] http://energy.senate.gov/public/index.cfm?FuseAction=PressReleases.Detail&PressRelease_id=bc681b26-6e4c-454f-82e9-f691774e65d6&Month=4&Year=2009&Party=0
[x] http://www.blm.gov/wo/st/en/prog/energy/oil_and_gas/EPCA_III.html
[xi] http://epw.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=04212e22-c1b3-41f2-b0ba-0da5eacad952
[xii] http://www.usatoday.com/news/washington/2011-05-13-lawmakers-renewable-energy-roadblocks_n.htm
[xiii] (The George Washington University, President Obama's Executive Order: Improving Regulation and Regulatory Review by Susan E. Dudley, Jan. 18, 2011).
[xiv] http://www.eia.doe.gov/emeu/steo/pub/contents.html
[xv] http://www.eia.doe.gov/todayinenergy/detail.cfm?id=390
[xvi] http://www.eia.doe.gov/emeu/steo/pub/contents.html
[xvii] Standard & Poors, Compustat North America Database (as of 4/13/11), spreadsheet, FY 2010xlsx
[xviii] http://www.conocophillips.com/EN/about/energy/energyissues/pages/profits.aspx
[xix] http://www.sonecon.com/docs/studies/0907_WhoOwnsOilCompanies.pdf; http://www.nj.gov/treasury/doinvest/pdf/directorreport211.pdf; https://www.tsp.gov/PDF/formspubs/tsplf14.pdf

STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER
U.S. SENATE COMMITTEE ON FINANCE HEARING OF MAY 12, 2011
OIL AND GAS TAX INCENTIVES AND RISING ENERGY PRICES

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining a variety of tax incentives and their impact on the American energy industry:

Mr. Chairman, everybody is angry about high gas prices. I can tell you I'm angry about it.

The press keeps telling us that we need America to come together, and put aside partisanship. Well, nothing makes for a kumbaya moment like high gas prices. Republicans don't like paying high gas prices any more than Democrats do. And with one voice Americans are telling us to do something about them.

Unfortunately, for some people the political philosophy of Rahm Emanuel is too hard to resist. Never let a crisis go to waste.

And so faced with an issue of legitimate concern for the American people, politicians and their media allies decide to exploit high gas prices for political gain.

This is a double game for those politicians. On the one hand, they are able to score some cheap political points against politically unpopular oil companies. On the other hand, all of their sound and fury signifies nothing. It is designed to distract their constituents from the simple fact that the Democrats have no energy policy.

Let me take that back. Actually, they do have an energy policy.

Are you ready for this? Their energy policy is to increase the cost of energy.

You heard that right. This is the President's Energy Secretary Steven Chu.

Somehow we have to figure out how to boost the price of gasoline to the levels in Europe. So while the American people ask Congress to do something about high gas prices, the response of Democrats is to rail against oil executives, to mask the fact that their policy is actually to make the price at the pump more painful.

And for what it is worth — for all of their talk about the shrinking middle class and income inequality — high gas prices don't hit Warren Buffet and Warren Beatty the hardest. They hit moms and dads who have to live far from where they work and drive minivans and SUVs because they have children.

When Al Gore has to pay a little more to gas up the private jet to fly to Cannes, he doesn't feel the pain.

But when my constituents in Utah see gas go above $4 a gallon, they have to make real choices about whether they have to work longer hours to make ends meet and whether they can send their children to camp this summer.

David Letterman captured this current situation brilliantly. Here's how Mr. Letterman put it. Gas prices, aren't they crazy?

It's so expensive that rats are carpooling in from New Jersey. I'd expect my friend from New Jersey to change the joke and stipulate that the rats arrive from the opposite direction. Of course, my friend from New York might take exception to that.

Now, we don't have as many rats in my home state of Utah. But, like folks in New Jersey and New York, Utahns are plenty angry about high gas prices. They are bearing the brunt of gas prices near $4 per gallon. This is very discouraging because we are still recovering from one of the worst recessions our country has ever faced, and all that these increased gas prices do is put the brakes on an already fragile recovery.

I hear from small businesses that are trying to make a profit and possibly hire more workers, but now have to make room for added energy expenses. I hear from families who are trying to work out how these gas prices will fit in their budgets. And I hear from those who are still looking for employment.

What the people of Utah and this country need is a forward-thinking energy policy that will address rising gas prices that are a lead weight around the neck of the economy.

I am not here to defend any particular industry. After all, I am one of the leading proponents of promoting alternative fuels.

But let's not make any mistake about what we are talking about here. Let's not gloss over the plan that is being offered here. The plan that is being offered here is to raise taxes. Americans are rightly upset about the cost of gasoline.

And the solution being offered here? Let's raise some taxes. Lawyers would call this a non sequitur. Everyday Americans would call it beside the point.

Raising taxes to address high energy prices is about as relevant as a person walking into a doctor's office complaining of chest pain, and having the doctor respond by offering to reupholster the patient's couch.

Families and businesses are being hit by high gas prices. This demands an energy policy. But all this hearing is about is providing a justification for tax increases.

I wish I could say I was surprised.

No matter what the question is, it seems that for the President and some of my colleagues, the answer is always raise taxes.

Government spends too much? Raise some taxes.

Health care too expensive? Raise some taxes.

Gas prices too expensive? I've got it . . . Let's raise some taxes!

I would be doing a grave disservice to my constituents if I was to ignore the consequences of these tax increases.

Some of us are trying to create American jobs, increase energy supply, and reduce dependence on foreign oil, at a time when we are still recovering from a historic economic collapse.

The proposals that will be discussed today are completely divorced from those pressing needs. The reasoning put forth for repealing these tax provisions — rising gas prices and reporting high first quarter profits — would set a bad precedent for future tax increases.

Are we to increase taxes any time a company sees an increase in quarterly profits due to high demand of a commodity? What if Wal-Mart's profits increased due to a spike in global demand for cotton?

What if an increase in demand for coffee results in Starbucks reporting record profits? What if the Hollywood studios hit a few home runs with some new films and record profits result? Well, I'm not going to hold my breath waiting for Democrats to haul George Clooney up here to justify his salary.

I do not believe we really want to go down the dangerous road of deterring American businesses from becoming too profitable.

This hearing should not be used to score cheap political points, but I'm afraid, with all due respect, Mr. Chairman, that is what we will see today. I have a chart depicting what I expect this hearing to turn into.

It is perfectly appropriate to examine the purpose, intent, design, and effectiveness of certain tax incentives that promote the domestic production of oil and gas. Let's have that debate. In 2004, Congress passed the American Jobs Creation Act. The centerpiece of that legislation was the Domestic Manufacturing Deduction. This particular provision was designed to strengthen the domestic manufacturing sector. It is a deduction for manufacturing everything from coffee to appliances to the domestic production of oil and gas. The amount of the deduction is specifically tied to wages paid to American workers.

The intent was not to incentivize manufacturing and production, but to manufacture and produce within the United States rather than overseas. Congress passed this provision with the expectation that it would promote economic growth and job creation here in the United States. It is important to note that this provision is not just tied to the oil and gas industry, but applies to income derived from all manufacturing within the United States.

Maybe we should have a meaningful conversation about whether this provision is good tax policy. Given that it impacts industries far outside the scope of the oil and gas industry, it is a conversation more properly suited to a debate over tax reform.

But I am not going to hold my breath waiting for this adult discussion of tax policy. Instead, I expect some good political theatre. The liberal mouthpieces over at MSNBC certainly had the talking points yesterday afternoon, and are ready to make some political hay at the expense of our witnesses today.

Many will point to a comment made by a former CEO that oil and gas companies do not need these tax provisions. That CEO might be right.

Oil and gas companies would probably drill with or without these tax incentives. But let's be clear. They would be less likely to do so in the United States. We have to ask whether we want to help increase the market share for U.S. corporations in the global oil and gas marketplace, or do we want to decrease that market share and put ourselves at the mercy of foreign importers?

I am not going to wait for the MSNBC lineup to put on their hardhats, stand on an oil rig, and do a promotional ad asking this tough question about the potential loss of blue collar American jobs.

We have a great number of resources that could be used to promote energy security within the United States. I applauded President Obama's recent pledge to reduce foreign oil imports by a third by 2020. However, I was taken aback when he told Brazil that we want to be their best customers if they increased their oil production.

So it is OK for other countries to produce the energy that will drive our economy, but it is wrong to produce it here at home?

To be honest, I do not know what the President and his administration's agenda is for energy security. And I don't expect to get any clarity on that point today. I think that is the point.

The American people are upset at high gas prices and are demanding energy solutions. The President has no solution. In fact, his policies would do precisely the opposite of what our constituents are asking for. They would increase the cost of domestic production and harm our economy.

So faced with the uncomfortable fact that the buck stops at the Oval Office, and that the President's only solution to high energy prices is to double down on them, liberals hope to distract the American people from their failure to develop a coherent energy strategy.

I do know that we currently depend on oil for our energy needs because it is abundant and dependable. Demand is and will remain high for the next decade. There is a reason why Florida's demand for petroleum-based transportation fuels is among the highest in the US. There is a reason why states like New Jersey and Maryland consume more gas per capita than most states.

And we certainly have the resources to help meet that demand.

Just recently, geologists have discovered in the western part of North Dakota and parts of Montana a twenty-five thousand square mile sea of oil that could hold the largest accumulation of oil identified in North America since 1968. They have dubbed it the Kuwait on the Prairie. About one hundred new oil wells are developed each month.

We also have a great deal of oil in the Rockies on public lands and off our coasts, but our President has done everything in his power to shut down federal leases in these areas.

Look, we all know politics is thick in the air here today. Our dog and pony would feel very much at home.

Many Democratic senators have admitted that it's good politics to take on oil companies when gas prices are high.

We all know everyone is angry about high pump prices. We don't need to hold a hearing on that. But, if we want to do something about it, three questions come to mind. I'll pursue these questions with the witnesses.

First question: will the policies proposed by the President and the Democratic Leadership cause pump prices to drop?

Second question: if pump prices do not drop, then what will the policies proposed by the President and the Democratic Leadership do? One possibility might be that these policies will cause the U.S. to become more dependent on imported oil.

Third question: with respect to tax incentives available for all U.S. manufacturers, is it wise to single out one industry and treat it differently? I'll put a finer point on the question. Is it wise to conduct business tax reform on a selective and punitive basis?

Let's send the pony back to the stable.

Let's send the dog back to the kennel.

Let's get back to reforming the tax code to support economic growth. So far in this Congress, we have been making progress on making the tax code more efficient, simpler, and fairer.

I hope the Chairman will continue these efforts.

###

L. Wright Allen to fill a vacancy on the Federal District Court for the Eastern District of Virginia. This is the fifth judicial nomination the Senate has considered since returning from the Easter recess. I hope this is a sign of progress. Another 11 judicial nominations are pending on the Senate's Executive Calendar, and with judicial vacancies around the country remaining above 90, we still have a long way to go to address the needs of the Federal judiciary.

Arenda Wright Allen's nomination has the strong support of both of her home State Senators, Senator WEBB and Senator WARNER. When she is confirmed, Ms. Wright Allen will become the first African-American woman to serve as a district court judge in Virginia. Her nomination was reported unanimously by the Judiciary Committee over a month ago, along with that of another Virginia nominee, Michael Francis Urbanski, who has been nominated to the Western District of Virginia.

In her 25-year legal career, Ms. Wright Allen has served as a Federal defense attorney, a Federal prosecutor, and a military attorney. She is currently a supervisory assistant Federal public defender in the Eastern District of Virginia having previously served as an assistant U.S. attorney and in the U.S. Navy's Judge Advocate General's Corps. It is vital to have men and women serve as judges who have been prosecutors and defense attorneys. This nominee has been both, and I am sure her experience will serve her well when she is confirmed.

Recently, Republican Senators have tried to twist qualified nominees' litigation experience against them. Their partisan attacks are not consistent. Republicans oppose some nominees by saying that they do not have sufficient litigation experience. When a nominee has extensive experience and is a successful trial lawyer, they reverse themselves and complain that the nominee has too much experience and will be biased by it. They opposed Judge McConnell of Rhode Island on this supposed ground. They opposed Judge Chen of California despite his 10 years as a fair and impartial Federal magistrate judge. I hope they will not now oppose Ms. Wright Allen because she served as a Federal public defender. All of these nominees have assured us that they understand the difference between being an advocate for a client and serving as a judge. I have no doubt that they do.

With continued cooperation from both sides of the aisle, the Senate should also consider the other 11 judicial nominees ready for final Senate action. We should certainly proceed with the judicial nominees for whom there is no opposition and no reason for delay. That would allow us to confirm another seven nominees. They have all been thoroughly reviewed by the members of the Judiciary Committee and have all been recommended to the Senate unanimously. They are Judge Urbanski; Clair C. Cecchi to fill a vacancy in New Jersey; Esther Salas to fill another vacancy in New Jersey; Paul Oetken and Paul Engelmayer to fill vacancies in the Southern District of New York; Ramona Manglona to fill a vacancy in the Marianas Islands; and Bernice Donald of Tennessee, to fill a vacancy on the Sixth Circuit.

I also hope that we can soon consider two of the nominees currently awaiting a Senate vote who have twice been considered by the Judiciary Committee and have twice been reported with strong bipartisan support, first last year and again in February. They are Susan Carney of Connecticut to fill a judicial emergency vacancy on Second Circuit and Michael Simon to fill a judicial emergency vacancy on the District Court in Oregon. We should also consider the nomination of Goodwin Liu to fill a judicial emergency vacancy on the Ninth Circuit, a nomination we have reported favorably three times, and the nomination of Caitlin Halligan to fill a judicial vacancy on the DC Circuit, which we reported favorably over 2 months ago.

All these nominees have a strong commitment to the rule of law and a demonstrated faithfulness to the Constitution. They should have an up-or-down vote after being considered by the Judiciary Committee and without additional weeks and months of needless delay.

Federal judicial vacancies around the country still number too many, and they have persisted for too long. Whereas the Democratic majority in the Senate reduced vacancies from 110 to 60 in President Bush's first 2 years, judicial vacancies still number 91 over 27 months into President Obama's term. By now, judicial vacancies should have been cut in half, but we have barely kept up with attrition. If we join together to consider all of the judicial nominations now on the Senate's Executive Calendar, we would be able to reduce vacancies to 80 for the first time since July 2009.

Regrettably, the Senate has not reduced vacancies as dramatically as we did during the Bush administration. In fact, the Senate has reversed course during the Obama administration, with the slow pace of confirmations keeping judicial vacancies at crisis levels. Over the 8 years of the Bush administration, from 2001 to 2009, we reduced judicial vacancies from 110 to a low of 34. That has now been reversed, with vacancies staying above 90 since August 2009. The vacancy rate—which we reduced from 10 percent at the end of President Clinton's term to 6 percent by this date in President Bush's third year and ultimately to less than 4 percent in 2008—is now back to more than 10 percent.

We have a long way to go to do as well as we did during President Bush's first term, when we confirmed 205 of his judicial nominations. We confirmed 100 of those judicial nominations during the 17 months I was chairman during President Bush's first 2 years in office. So far, well into President Obama's third year in office, the Senate has only been allowed to consider 82 of President Obama's Federal circuit and district court nominees, well short of 205.

The last 2 weeks are a sign that the Senate can consider these nominations. We must work together to ensure that the Federal judiciary has the judges it needs to provide justice to Americans in courts throughout the country. Judicial vacancies throughout the country hinder the Federal judiciary's ability to fulfill its constitutional role. That is why Chief Justice Roberts, Attorney General Holder, and the President of the United States have spoken out and urged the Senate to act.

I congratulate Ms. Wright Allen and her family on her confirmation today.

The Senator from Alaska is recognized.

Mr. BEGICH. Mr. President, I ask unanimous consent to speak as in morning business and that the time be counted against the Democratic side.

The PRESIDING OFFICER. Without objection, it is so ordered.

ENERGY SECURITY

Mr. BEGICH. Mr. President, I say to my friend from Oklahoma, absolutely, I am aware of the quantity and value of Alaska oil and gas today. I rise to discuss this issue, as well as a few others related to the issues of oil and gas.

I rise to discuss an issue foremost on the minds of my constituents and a concern to all Americans: the rising cost of energy. I wish to outline the proposals aimed at providing short-term relief for high prices at the pump and to ensure America's long-term energy security. These are the issues which have been discussed many times in this Chamber. The time for talk has passed. The time to act is now. High energy prices today already are pinching the pocketbooks of families and crippling our small businesses across my State and across this country.

When I was home over the recess, I visited the roaded areas of Alaska. These are communities connected by our highway road system, from Kenai Peninsula to Fairbanks, where gas prices are well over $4 a gallon. As one can see on the poster next to me, they range from $4.15 to $4.45 a gallon. These prices might look good to some of my colleagues who saw gas prices over $5 a gallon in their States, but off the road system in Alaska prices are much higher. The fact is prices for gasoline and home heating oil never came down in rural Alaska. They have been well over $5 a gallon for years. Some places, such as Anaktuvuk Pass are nearly $10 a gallon.

I started a discussion with Alaskans on Facebook to just see how these high prices are affecting their budgets.

Some families are already facing tough choices to make their budgets balance. For families commuting into Anchorage from the Mat-Su Valley every day, they are forced to pay more than $100 a week to fuel up. That is

more than a pocketbook pinch, it is a punch.

Even worse, families know the price isn't coming down anytime soon. Even though speculation ranges all over the place, prices are expected to rise still another 30 to 40 cents by July.

Mr. President, families know the price of fuel is not coming down anytime soon. As I mentioned, it is continuing to rise. It is not just affecting families but businesses. They feel the sticker shock also at the pump. We are seeing businesses through rising food and delivery prices making up the difference. These families and businesses expect us to act now. No more excuses.

Energy is one place where we should be able to find bipartisan common ground. I have been calling for a comprehensive energy bill from day one in the Senate. Our lack of progress is frustrating. We were real close last spring, but now here we are again.

We need to provide Americans with reliable and affordable energy in three ways: short-term relief for consumers, new renewable energy sources for reliable electricity prices and keep strong investment in alternative transportation systems, and increase domestic oil and gas production so we are not dependent on unfriendly foreign sources.

First, the short term, which I call the pocketbook relief. We must help families keep their budgets balanced and help ensure that increasing consumer confidence doesn't falter. To do that, I have introduced the Family Account to Save on Transportation—or the FAST Act—to help families get through high gas prices over the next 2 years.

This bill will allow us to set up pretax transportation savings accounts—just like medical savings accounts—to help offset the pain of high gas prices on the family pocketbook. The bill would sunset in 2 years, so it would have no long-term burden on the Federal budget.

Second, we have to bring online alternative power sources to buffer power companies from price shocks of rising oil and gas prices. No matter where you are in Alaska, you don't have to go far to find alternative energy sources—wind, tidal, geothermal, and hydro. Even in these tough budget times, this is a good investment to strengthen our economy far into the future.

The same is true for alternative transportation systems and fuels. We must fully support efforts to develop electric, hybrid, and highly efficient vehicles. At the same time we must recognize most working families cannot afford to purchase a new vehicle. So we need to find other ways to reduce their transportation costs, such as greater investment in city-to-city commuter services.

The recent investment in high-speed rail is positive but is not reaching most of the country, and will not. Even in Alaska we have the potential for commuter rail. It is critical to move commuters from city to city and cut the $100-a-week gas prices folks from Mat-Su pay as they drive into Anchorage for employment.

Solving our energy security challenge cannot just focus on reducing consumption. Yes, it is important. But we must cut the use of fossil fuels in all sectors—as identified through consumption, especially transportation—but we also need to increase our domestic production.

Every new oil and gas development buys our country more energy and national security while also creating American jobs. Unfortunately, we are going in the wrong direction. Thirty years ago, 28 percent of our oil was imported; today it is 60 percent.

While our largest share of oil imports comes from Canada, too much is coming from unstable countries or those openly hostile to the United States. Not only will we become increasingly dependent on these countries for our oil, we are exporting over $1 billion a day. Let me repeat that: We export $1 billion a day.

In my home State of Alaska we have vast potential to increase America's energy security. The fact is, developing Alaska's oil and gas resources buys our country decades of energy security by offsetting foreign imports from unfriendly countries.

Consider a few examples which I have reflected on the board next to me.

Developing offshore resources in the Chukchi and the Beaufort Sea will produce 1.8 million barrels of oil a day. This is easily enough to offset oil imports from Saudi Arabia. We could even cover Iraq too. Developing the oil beneath the Arctic National Wildlife Refuge, ANWR, could offset imports from Nigeria. Developing the CD–5 project in the National Petroleum Reserve-Alaska—the National Petroleum Reserve-Alaska, set up for petroleum products and production—and BP's Liberty project could replace daily imports from Libya.

This does not even include the tremendous onshore and offshore natural gas resources we have in Alaska. One-third of the country's supply is in Alaska. So why aren't we developing these enormous resources in my State? Two words: politics, bureaucrats.

Mr. President, earlier this year President Obama went to Brazil where he declared that America wants to be a customer for Brazilian oil and natural gas. I have to say, we don't need to go to Brazil to do that. We can do it right here in Alaska, with our people, our resources and our opportunities. I reminded the President of that, and I will remind him on a regular basis. To his credit, I will say later in the month he did mention Alaska. In his call for energy and domestic energy independence, he mentioned Alaska.

Unfortunately, the bureaucrats in his administration are not listening. They are tossing up barriers to additional Alaskan oil and gas production every chance they get. Sadly, some of my colleagues in this body are not much better. Instead of addressing the problem with specific solutions, they are going for headlines by dragging energy company executives before committees or proposing the rollback of incentives for increased domestic energy production, some of which have been on the books for decades.

Let's stop the headline grabbing and get serious about energy security. I have three ideas: First, better coordinate the Federal offshore permitting process. I introduced legislation before our recess to create the Arctic OCS Coordinator, modeled after legislation the late Senator Ted Stevens passed establishing a Federal gas pipeline coordinator. My bill addresses the problem too many projects are caught up in.

The PRESIDING OFFICER. The Senator's time has expired.

Mr. BEGICH. I ask unanimous consent for an additional 3 minutes.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. BEGICH. Too many projects are caught up in what I call the "regulatory whack-a-mole." You think you have smacked down one regulatory hurdle and another one pops up. My bill would give authority to work across the agencies causing companies so much heartburn today—the EPA, the Army Corps of Engineers, and the Department of the Interior, just to name a few.

Second, let's align the clean air standards for offshore drilling permits among the affected Federal agencies. We must have a level playing field whether you are in Alaska or the Gulf of Mexico or the Eastern United States.

As my colleague from Louisiana knows—who is here joining me on the floor—Louisiana has one rule, and Alaska has another rule for the same issue.

Third, let's invest in American transportation and safety infrastructure to develop oil and gas resources in frontier areas. The fact is, we need a far greater Coast Guard presence in the Arctic for oilspill prevention and response.

We also need to invest in our pipeline infrastructure, including the Alaskan Natural Gasoline, to move oil and gas resources from the Arctic to other U.S. regions.

There is a lot of talk right now about ending tax incentives for the oil and gas industry. With the high profits right now, these companies are easy targets. But one thing every Alaskan knows—just because you have an easy target doesn't mean it is the right thing to shoot. It would not decrease gas prices at the pump for our families and our small businesses. It will discourage companies, especially the independents, from domestic investment and job creation.

As someone who represents a State with the highest energy prices in the country, and some of the best renewable and traditional energy resources, I am ready to join my colleagues on both

sides of the aisle to address America's energy needs now. We need to set a hard target. That is why I am asking my colleagues to get serious about a real energy plan and give Americans freedom from high gas prices by the Fourth of July.

Let's work together, roll up our sleeves and pass a real comprehensive energy plan our families and our small businesses can get behind. Let's finally invest in our energy future and put the reforms in place for our long-term energy security.

Mr. President, I recognize my colleague from Louisiana—another great State for oil and gas development—is on the floor with me, and I yield the floor at this time.

The PRESIDING OFFICER. The Senator from Louisiana.

Ms. LANDRIEU. Mr. President, I thank my colleague from Alaska for asking me to join him in a general presentation and potential colloquy between the two of us about the importance of continuing our support for oil and gas production in the United States by the large international companies that have operated in our country and around the world now for many years, as well as by the hundreds, if not thousands, of independents that operate doing the same.

There is going to be a bill that will be debated in the Senate Finance Committee tomorrow. It is S. 940, sponsored by the Senator from New Jersey, our colleague, Senator MENENDEZ. I want to go on record in strongly opposing it, and I will give some reasons why, and I urge my colleagues, when this bill comes up—which I understand it will come directly to the floor of the Senate without being heard, as is tradition, in the committee—to vote it down.

I doubt the bill, in its current form—or in any form that it could be modified—can get the 60 votes necessary for passage, but I would like to add my strong voice in urging my colleagues to read this bill, to look at it and understand the inherent unfairness in it, the lack of significant deficit reduction, and the fact that it will not—although it is being touted to do so—reduce gasoline prices by one penny.

Mr. President, I want to start with some facts that people might find very interesting, or hard to believe, based on the political rhetoric they have been hearing from the sponsors of this bill and others in the Senate. The story line goes something like this: Big oil makes huge profits at the expense of everyone. They pay virtually nothing in taxes, and we subsidize them. Why are we doing this? Why don't we stop?

I think it would be good to get a few things clarified for the record. It may be surprising to American taxpayers to know that of the $16.6 billion spent on U.S. energy subsidies over the course of 1 year, oil and gas subsidies account for less than 13 percent. I want to say that again. Of the $16.6 billion spent on U.S. energy subsidies over the course of 1 year, fuels such as renewables, refined coal, nuclear, solar, hydro, et cetera, account for 85 percent. Oil and gas is less than 15 percent—actually, 13 percent.

Now, you would think because of this bill, S. 940, that big oil and gas companies are getting all the subsidies, making all the profits, paying no taxes, and the rest of us are suffering. Nothing could be further from the truth.

Let me repeat: This bill, S. 940, is going to repeal virtually all subsidies from one industry, and one sector of one industry—oil and gas companies—but they only get 13 percent of all the energy subsidies.

Why aren't we talking about the other 85 percent? Some of them—in some people's minds—create some harm to the environment, whether it be dams blocking up rivers so fisheries are extinct or whether it is coal that has its own issues. Of course nuclear doesn't have any problems. We must not be paying attention to what is happening in Japan. Why are we singling out one sector of one part of the energy industry to repeal the subsidies when it will, in fact, have the opposite effect of reducing gasoline prices? Even one of its cosponsors said publicly for us not to be fooled, this will not reduce gasoline prices. Why are we doing it? Will it create jobs? No. It will actually hurt job production in the United States.

According to the EIA study—which is the U.S. Government, not a company—published in 2008, the oil and natural gas industry received 13 percent of the subsidies while producing 60 percent of the energy. Let me repeat. This industry got only 13 percent of the subsidies but produced 60 percent of the energy. But the bill, S. 940, is going to be debated in the Finance Committee where the industry leaders are going to be called to talk about this gimmick, 940, but the oil and gas industry, with their independent counterparts, produced 60 percent of the energy.

I would like to say where exactly that energy comes from because it really is a bone of contention. The Senator from Alaska will appreciate this. The sponsor of this bill represents a State that is one of the highest deficit energy-producing States in the Nation because some of us do this better than others. Louisiana produces a lot of energy. Alaska produces a lot of energy. Texas produces a lot of energy.

Some States like to consume a lot and produce nothing. That would be like some of our States that put some of their land in agriculture so they can produce food—other States saying: We don't want to produce food, but we expect you to provide it to us—provide it to us when we want it, how we want it, and for the price we want it. And I am tired of it, and so are the people I represent.

I want to put this deficit chart up here. We have seen a lot of deficit charts about deficits of infrastructure, real deficits of money, debt. Let me talk to you about the deficit and the debt owed by some States in this Union that consume a lot, talk a lot, and produce nothing.

California has the greatest deficit. It consumes a tremendous amount of energy, and the imbalance is the highest. It produces the least, consumes the most. To California's benefit, before Senators FEINSTEIN and BOXER run down here to argue this point, I want to concede this one point: California has been on the forefront of energy conservation and efficiency. This chart does not recognize them for that, but I will concede that point, and I am going to have some further data to explain that. California, while it doesn't produce a lot of energy—it consumes a tremendous amount—at least California has been in the forefront of savings and efficiency because there are a lot of States up here that don't produce, don't conserve, are not efficient, and all they want to do is yell about high gas prices. Why don't you do something about it?

Florida is a perfect example. Florida has a net deficit in Btu's. I guess it is 3.889 billion. Florida is a great example. I don't think Florida does much in nuclear. I don't think they do much in hydro. They have a lot of Sun; I don't know how much solar they are doing. They will not let anybody produce oil and gas on or off their shores, but they sure fill up a lot of their gas tanks every day. They sure fire up those hotels and those restaurants with that energy. Where do they get their energy from? If it weren't so serious, it would be laughable. They have a gas line that goes from Mobile, AL, to the Florida peninsula. We pump the gas out of Louisiana, Mississippi, and Alabama, put it in a pipeline, and ship it under the Gulf of Mexico so they can light up their State. Would they ever think of putting in an oil and gas well or building a nuclear powerplant? If they can't do that, why don't they conserve their energy?

New York is another user of energy which produces very little; Ohio, Georgia, New Jersey, North Carolina, Michigan, and Illinois. Some of these States, such as New Jersey and Michigan—think about what they look like. They have big factories, they have big industries. Michigan is home to the automobile industry, so they use a lot of gas in producing things we all use, so we want to give them credit for that. But still the fact remains that Michigan uses a lot more energy than it produces.

Then you get down here to what I call the gold-star States.

We get criticized so much, we are treated like we are some sort of pariah sometimes, but I think we do a great job—Kentucky, Alaska, New Mexico, Louisiana, West Virginia, and Wyoming. Alaska is up here somewhere—Alaska is right here. Kentucky, Alaska, New Mexico, Louisiana, West Virginia, and Wyoming. We produce enough energy for everybody in our State, what we need, and we export it to everyone else in America who needs

it. And what do we get? We get bills like this that go after, directly, the big companies in our State, that work in our State, to somehow put them in a position to make them feel as if they are not really good companies, they are not American companies, they don't pay tax, they get all these subsidies. I am going to read into the record what taxes they pay. It is going to surprise you. Then, on top of that, we get moratoriums, we get permatoriums. We can't even drill for the oil we have. We can't even look for the oil we might have.

When I go home, my people ask me—and it is a very hard thing for me to answer, and maybe they ask Senator BEGICH the same thing—they say: Senator, since we do so much to produce energy for the country, why do we pay $4 a gallon for gasoline and sometimes we pay a little bit more than everybody else? They don't produce anything, Senator. Why do we pay so much?

Can the Senator tell me what he answers his people because I don't know what to tell them other than this place is a little screwed up. Until I get an answer for that, and I will ask the Senator—go ahead, what do you tell them?

Mr. BEGICH. That is a hard one to answer because they see the oil flowing. As I mentioned, we have $10-a-gallon gas in some of our communities—$10 a gallon. So it is hard to explain that, yes, we are the big producer, but the rest of the country then picks on us.

I am just listening, and it is unbelievable, the green slice you have there.

Ms. LANDRIEU. I say to the Senator, because he raises an excellent point, President Obama is not the first President to go overseas and ask them to produce more oil to send it to us. This goes on—President Clinton did it. President Bush did it. We beg Saudi Arabia to produce more energy. We ask OPEC to please don't tighten it so much so our prices—why don't you go to the local OPEC or the local producers, which are Kentucky, Alaska, New Mexico, West Virginia, Louisiana, and Wyoming? Why don't you help us produce more, because we can do it. But we get shut down by bureaucracy, moratoriums, permatoriums, rules, regulations, EPA, refuges. We can't even get free to produce the energy that we can produce for this country. Then you have all these middle States that do a fairly good job on balance.

But I tell you, if we passed a law here that said every State in America had to produce the energy it needed, we would have an energy policy all right, Senator BEGICH knows. I don't know what it would be, but it would be an interesting rule, you know, just like in the old days—if you wanted food, you produced it. It would be a great law. Every State in America, all 50, if you consume energy, you need to produce something. You could produce it by wind; you could produce it by hydro; you could produce it by nuclear; you could stop driving your automobiles and have everybody walk; you could give everybody a bicycle. We don't care. Just eliminate the energy deficit. That would be a very interesting discussion to have, and I might even file a bill like that because this one is so ridiculous, people might actually read the one I would file.

Let me give a couple of other stats, and then I know I am exceeding my time. I want to ask for 2 more minutes. I want to put to rest this issue that the big oil companies don't pay any taxes.

This is from Forbes magazine, so take it as it is. It is slanted toward industry, I give you that. It is not left of center, it is right of center, sometimes very right, but I think you can check these figures with anybody else. I am assuming they are accurate. This is for the top 20 most profitable U.S. corporations in 2010.

ExxonMobil's net income was $30 billion. Their tax rate was not 10 percent, not 15 percent, not 25 percent, not 35 percent—a 45-percent tax rate. Their estimated worldwide tax bill was $90 billion. Of $10 billion in total taxes paid in the United States, $3 billion was income tax. Let's go on. ConocoPhillips' tax rate was 42 percent; pre-income tax, $19.8 billion; net, $11.4; tax rate, 42. Chevron was 40 percent.

So let's review: Exxon, 45 percent; Conoco, 42; and Chevron, 40. Do you want to know what Google was? Google is a pretty big company. They don't produce oil and gas. They have another line of business. Their tax rate was only 21 percent.

Let's take Hewlett-Packard—not in my State, in other parts of the country. Their headquarters is not in the South. Their tax rate was 20 percent. Apple Computer's tax rate was 24 percent.

People will say: It is not just the rate; it is what you paid. But I think if you look—Coca-Cola, very big company, their tax rate was down to 16.7 percent.

Does this make sense? No. So that is why we need tax reform, significant transformational tax reform, so all big companies pay similar in taxes and we eliminate some of these loopholes that don't make sense. I could be for that. I could be for that when we are talking about Google, Apple, GM, GE, ExxonMobil, and Chevron. But if you are going to ask me to stand here and pick on one industry that pays billions of dollars in taxes, that only gets 13 percent of the energy subsidies, that hires—350,000 people in my State are hired by oil and gas companies or their contractors or affiliates, large and small, not just the large. And when I see what our people produce and these States produce nothing, or virtually nothing, and you ask me can I vote for a bill like this? No. Not only can I not vote for it, it is laughable.

I hope the Senator from Alaska and I—I know we are going to be the skunks at the garden party because, as Democrats, to be against this bill, it is going to be because we just have to coddle this industry. I don't coddle this industry. I am holding BP's feet to the fire. I want Exxon to pay the tax they owe. I want Chevron to pay the tax they owe. I want this President and this administration to stop the moratorium and the permatorium in the gulf. I want to get our people back to work.

I would much love to reduce gasoline prices, and one way we could do it is if cars did not have to be so dependent on gasoline. Why don't we give a significant subsidy to produce different kinds of automobiles? I would vote for that. I have voted for that. If you had a car right now running on natural gas, you would be paying the equivalent of $2 a gallon for gasoline at the pump. That is much better, I say to the Senator, than $10. Why don't we take some money and invest in natural gas vehicles or more incentive for electric vehicles? If people are really serious about breaking the back of OPEC, then start building the kinds of automobiles and infrastructure in this country necessary to do it and stop introducing gimmicks such as this that might get you a few political points in the short run, but it is not leading us in the right direction.

Having beat up on the Democrats, let me say something about the Republican side.

All they want to talk about is drill, drill, drill. We cannot drill our way out of the situation we are in. Do I want to drill more? Yes. Do I think there is more than 2 percent of the world's oil and gas in America? Yes. But you know what? You have to look for it in order to find it.

We are under certain provisions—the Senator knows in Alaska, we cannot even go look for the oil and gas we might have. The Senator might want to talk about that, and I am going to close in a minute.

Mr. BEGICH. To the Senator from Louisiana, let me say, when you describe the moratorium or whatever they call it in the gulf, it is even worse in the Arctic, or even on, as I mentioned when I had the map and I showed the National Petroleum Reserve. That is not a name picked out of the sky by the industry. That was set aside by the government to prepare our country for more energy independence decades ago.

We cannot even get a permit to go across—in some places, they call it a stream. But everyone else now calls it a big river. It is not. It is a very small area. But a bridge to go over to explore for what you described—we cannot even get onto the land the government set aside that would then determine if we have oil and gas. We believe there is, because obviously they have—it is set aside as the National Petroleum Reserve.

But the other piece to this—the Senator hammered away on it and I agree with her—if we are skunks at the garden, so be it, because it is a question of

fairness. As the Senator described the 13 percent of the subsidies or incentives they receive, they produce 60 percent of the energy. But her other statistic is even more dramatic.

Of the remaining 87 percent of those subsidies, they only produce 40 percent of the energy. If this were a business, you would eliminate that part of the equation because it does not give a good return on investment. But we are still doing that, because there is a lot of politics being played.

The point on the tax issue. Like the Senator, I think there should be an overhaul to this tax system. But picking on one industry because it sounds good, rates good in the polls, gets you a couple of headlines, is not what the American people want us to do here. If anything, they are getting fed up with that.

What they want us to do is sit down and, as you have described so eloquently in the description of the country, you bet, I would love every State to do it, produce. Then they would see what we go through. Because we are a collective group of States, we do our part, but we should not be picked up because we do more than our share, because we are trying to help out States that are producing vehicles or producing, you know, a lot of chemical industry, and other things, or the pharmaceutical industry. We can go through those lists that somehow do not end up on these, getting rid of their subsidies.

Your point is right on. If there is anything we should be doing right now—I agree with the Senator—it is the issue of—when I open the paper and I see administration officials, current and past, saying the way we are going to control our energy cost is talk to Saudi Arabia. Is that our energy policy? Because that sure the heck is one that, one, does not create one job here; two, is the worst national policy from a national security perspective; and, three, it is foolish, as I mentioned earlier, that we export $1 billion a day out of this country to buy from countries—and in some cases good allies. Canada is a good example. Some of these countries are not our friends, but we are giving them cash so they can then use it against us. It does not make any sense. You are right, this piece of legislation they have put down without a committee process on it is a gimmick; a gimmick to get the next week of activity, get some press out there. But we have to be serious.

I appreciate the Senator yielding for me to rant a little bit. I am glad you said the part too, the assumption is that these companies pay no taxes, that somehow they get the subsidies and they pay nothing. You bet you they are profitable. They are big companies. They are huge companies. But they pay taxes in the billions to the Treasury of this government. When you listed out all of those differential rates, that is again why we need tax reform. Then I am happy to have this discussion, but not singling out an industry because it is a good political score and good fodder for the newsprint and everything else. I appreciate the Senator yielding me a few more minutes to ramble there a little bit.

Ms. LANDRIEU. I thank the Senator. I wish to ask the Senator a final point. We are going to hear tomorrow speeches given about America is at the highest production levels ever. That may be true. But it is true for a very short period of time—maybe the next month or two—because as you can see, there is going to be a precipitous fall. Why? Because of the Deepwater Horizon, the shutdown in the Gulf of Mexico. Even though people say we are at the highest production levels we ever have been, it is going to be temporary. Then the production levels are going to decline down to the lowest level since 1997.

I want people to understand, we are not on a path to produce more in America. We are on a path to produce less. And taking all subsidies away from the five major international oil companies is not going to change this line. It is going to make it continue to go down. It is not going to reduce the price of gasoline at the pump, not by one penny. It is not going to get us on the path to a strong, sound energy policy.

I will say in conclusion, should some of these subsidies and tax credits be looked at? Yes, in a comprehensive format. And I will say, I will be open to the ones that are the least effective, the least necessary, and are fairly applied across companies such as Google, AT&T, GE, and other companies. I will be happy to do my part. People in Louisiana will do our part.

But we are not, along with Texas and Oklahoma and Alaska, going to take it all on our shoulders. We have had enough. We have had high water. We have had high wind. We now have a high river. We have a moratorium. We have a permitatorium, and now we have no more subsidies.

At least they left the independents out. I want to thank them for not putting independent oil and gas companies in this bill. But still, the big five pay a significant amount of tax. They take a smaller percentage of the overall subsidy. I think we need to do this in a fairer way.

I am yielding my time.

Mr. BEGICH. If I can make one last comment, the chart that you have up there, there is one other piece on there. It is the Alaska oil pipeline. We are at a little over 600,000 barrels a day going through there. We are losing 6 to 7 percent a year in volume, and it will not be a question—somebody will say: Well, you will get down to zero and then you will stop the pipeline. No. No. When we get down to a level of 300,000 or 400,000 barrels, then it will be questionable if we can even run the line. Then you can actually potentially shut off the whole volume. So the chart there is important because we have to look at the long term. Because if we decide today to have a comprehensive energy plan that includes conservation, alternative energy, renewable energy and, yes, domestic production, the Senator from Louisiana knows, as I know, you cannot walk down the street and say, we are going to start drilling tomorrow and suddenly, voila, there is fuel. It is a 7- to 10-year process. So that chart is a critical chart, because in order to reach that decline, you have to start doing something today. Unless we decide the policy of this country, what the energy policy of this country is, we will pick up the phone and we will call Saudi Arabia, Nigeria, Iraq, Iran, Libya—that is the list, that is our policy—then so be it. I think that is the worst policy we could have ever for this country.

Again, thank you to the Senator from Louisiana. Again, if we are skunks at the garden, my view is we will be good-smelling skunks.

I suggest the absence of a quorum.

The PRESIDING OFFICER. The clerk will call the roll.

The legislative clerk proceeded to call the roll.

Mr. GRASSLEY. Mr. President, I ask unanimous consent that the order for the quorum call be rescinded.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. GRASSLEY. Mr. President, today the Senate continues its very rapid pace to confirm another of President Obama's judicial nominees. The Judiciary Committee's workload has not slowed since this Congress convened. I am pleased to report we are ahead of the pace of the 108th Congress. With this vote, the Senate will have confirmed 22 nominees in just 47 days. That is a rate of one judge almost every other day of Senate session. We have confirmed 32 percent of President Obama's judicial nominees this Congress compared to only 29 percent of President Bush's confirmed during the same time period.

We have also reported out of committee another 11 nominees. We have reported out of committee 46 percent of President Obama's nominees sent to the Senate this year. That exceeds the 38 percent of President Bush's nominees reported out during a comparable period.

Furthermore, we have held hearings on 10 nominees. Some of those, I expect, will be reported out of committee at our markup scheduled for tomorrow. In total, we have taken positive action on 43 of 71 judicial nominees submitted this Congress or approximately 61 percent of all nominees. I hope these facts will put to rest, once and for all, any complaints that we are delaying or obstructing judicial nominees.

There are currently 89 vacancies before the courts. Yet the President has not sent nominees for 51 percent of those vacancies. He has, however, sent the Senate four nominees for seats which are not yet vacant. This is perplexing to me since the current vacancy rate is 10 percent. I would think

United States Senate
Committee on Finance
Statement of Lamar McKay
Chairman & President, BP America
May 12, 2011

Mr. Chairman, Ranking Member Hatch, members of the Committee, good morning. My name is Lamar McKay, and I am Chairman and President of BP America.

I appreciate the opportunity to address the issue of energy tax incentives today. Before doing so, I would like to provide some context on BP's operations and investments in the U.S., both in traditional and renewable energy.

BP's Operations and Investments in America

BP has a long history in the United States energy market, with 23,000 United States employees and operations spread across the US. We are committed to providing the United States with the energy it needs to grow in the coming decades, and doing so in a responsible and sustainable manner. We are not only one of the largest oil and natural gas producers in the United States, but our investments across the entire energy spectrum are significant: we have a broad and diverse energy portfolio that makes us one of the nation's largest energy investors.

Over the five years ending in 2009 we have invested more than $37 billion in development of US energy supply. We continue to invest in natural gas production from the Rocky Mountain West and our existing shale gas regions. We have significant oil production in Alaska and the Gulf of Mexico. Further, we have made, and are continuing to make, significant investments in our refineries in the US, including major capital projects that will increase gasoline production capacity at our key Midwestern refineries.

We also invest actively in renewable energy. During 2009, we invested nearly a billion dollars or 10 percent of our $9.9 billion US capital budget in alternative energy. These investments include the operation of wind farms in ten states; and development of the first commercial scale cellulosic biofuels facility in Florida and work on an advanced biofuels molecule – biobutanol – with DuPont; and our solar business, which has been in operation for over 35 years.

This investment in alternative energy is paying important dividends. For example, due to our investment in wind generation, we currently operate ten wind farms with a generating capacity of over 1,300 megawatts, with a further

1,000 megawatts in an advanced stage of development. That is enough power to supply a city the size of Washington, DC.

In addition, we are already one of the largest blenders of ethanol in the nation, and we are investing more than $500 million in the search for a new generation of biofuels that contain more energy, have less impact on the environment, and are not made with a food crop.

To be clear, BP America is working hard to expand and diversify US energy supply and is committed to reducing the environmental impact of both energy production and consumption.

BP's Commitments to the Gulf of Mexico

Last month marked one year since the Deepwater Horizon accident. We regret the loss of life and the impact on the communities and environment of the Gulf Coast states.

We continue to work hard to meet our commitments in the Gulf of Mexico. We have paid more than $6 billion for claims filed by individuals, businesses, and government entities.

We also have made more than $130 million of grants to the Gulf Coast states, and we have committed $500 million for the Gulf of Mexico Research Initiative, which is funding independent research to investigate ecosystem impacts from last summer's spill.

BP has also recently signed an important agreement with federal and state agencies that commits up to $1 billion for projects that will accelerate work, starting this year, to restore areas of the Gulf of Mexico that were affected by the *Deepwater Horizon* accident.

Sustaining America's Energy Supply for the Long Term

BP supports a comprehensive energy policy that includes all forms of energy, including oil, natural gas, coal, nuclear, biofuels, wind and solar and encourages efficiency and conservation. The reality is that, even with major improvements in energy efficiency and the rapid growth of biofuels, wind, and solar, twenty years from now – in 2030 – the United States will still depend on oil, natural gas and coal to meet more than three-quarters of its energy needs.

The United States – with five percent of the world's population – consumes 22 percent of daily world oil production. We support steps to help the US produce more domestic sources of energy, as well as steps to help the United States use

that energy efficiently. In other words, US energy policy must address both energy supply and energy demand.

On the supply side: we support properly scaled, transitional incentives for alternative energy. But raising taxes on one form of energy to encourage production of another will reduce industry's ability to keep up with growing US energy demand. The result could be less investment, less production, tighter energy markets and, over time, potentially higher prices for consumers. Instead, our nation should be encouraging production of all forms of energy – including oil and natural gas.

On the demand side, energy policy should encourage conservation and help drive energy efficiency.

The energy challenges facing this nation are enormous. The impacts of high energy prices on the overall economy and the American people are real, but we cannot change the world's crude oil market, which drives those prices and on which the country relies for 60 percent of the oil it consumes.

But we can work with the Congress, with the Administration, and consumers across the nation to move towards greater energy security and a lower carbon energy future.

Congress establishes the rules regarding energy and tax policy. Companies take those rules into account in making their investment decisions. Because of the long-term nature of the significant capital investments required to develop and produce energy, a stable and competitive tax framework is critical to the United States remaining attractive in the global demand for capital investment. Changes to tax rules being contemplated would limit the amount of resources companies like BP have to invest, not only in conventional energy production, but also in new and emerging technologies like wind, biofuels and solar.

BP is serious about bringing new sources of oil and natural gas to the US market. We are also serious about building a sustainable, profitable alternative energy business capable of delivering clean, affordable power.

My company stands ready to work with you and others to address the energy and environmental needs of this nation.

Thank you.

POST-HEARING QUESTIONS FOR THE RECORD
UNITED STATES SENATE COMMITTEE ON FINANCE
MR. H. LAMAR MCKAY, CHAIRMAN AND PRESIDENT, BP AMERICA, INC.
"OIL AND GAS TAX INCENTIVES AND RISING ENERGY PRICES"
HEARING HELD ON MAY 12, 2011
QUESTIONS DATED MAY 19, 2011

ANSWER SET

JUNE 20, 2011

QUESTIONS FROM SENATOR BAUCUS:

1. **Exxon Mobile has a recent posting by Ken Cohen, V.P. of Public and Government Affairs on its "policy blog" titled "ExxonMobil's U.S. taxes and U.S. earnings— Some relevant numbers for Washington. Mr. Cohen states that ExxonMobil had total tax expense of $9.8 billion in 2010 which exceeded total U.S. operating earnings of $7.5 billion. Footnote 18 of ExxonMobil's the 2010 Form 10-K filed with the SEC provides a breakdown of the total $9.8 billion. It includes $6.2 billion in "sales-based taxes".**

   I would like to ask each of you to describe the nature and amount of these U.S." sales based taxes" that you include as a tax expense in your financial statements. Are they federal excise taxes that are included in the price at the pump and effectively paid by consumers? Also, are these amounts included in your total sales reported on the income statement and therefore offset the amount reported as an expense?

   If these taxes are effectively passed on to consumers, isn't describing them generally as taxes paid by your companies similar to a retailer claiming that they pay the state and local sales taxes that they collect from consumers and remit to the appropriate governmental authorities?

BP recognizes that sales based taxes that are collected from consumers and remitted to the appropriate governmental authorities are distinct from taxes paid by BP but not collected directly from consumers. BP's Form 20-F filings reflect this distinction. Revenues are presented net of tax, except for retained taxes, and receivables and payables include sales tax – as reflected in the following excerpt from BP's 2010 Form 20-F:

> Customs duties and sales taxes
> Revenues, expenses and assets are recognized net of the amount of customs duties or sales tax except:
>
> - Where the customs duty or sales tax incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the customs duty or sales tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable.
> - Receivables and payables are stated with the amount of customs duty or sales tax included.

2. According to ExxonMobil's 10-K for 2010, for every 1 dollar increase in the price of oil, ExxonMobil earns a 375 million after-tax profit.

Last year, the average price of a barrel of oil was 72 dollars. The price of oil today is around 100 dollars and is projected to average over 100 dollars for the year.

Doing simple math, if prices do average 100 dollars this year, ExxonMobil stands to earn in excess of 10 billion dollars in additional profit in 2011 than in 2010 just due to the increase in the price of oil.

In contrast, the total amount of tax breaks under consideration today is approximately 2 billion dollars for all the companies at the table combined.

I'd like to know from the other four companies how much in after-tax profit you earn from each 1 dollar increase in the price of oil.

Wouldn't each of you agree that a price change of two or three dollars in a barrel of crude oil has a more meaningful impact on your investment decisions than your share of the effect of repealing all the tax provisions under consideration today?

Isn't the value of a price of oil the most important driver for your business planning?

Would you really consider producing less in the United States with the significant profits you earn with every additional barrel of oil produced?

BP must make decisions about how to allocate its capital resources by considering a number of business factors in the context of the global competition for energy investment capital. Given that oil is a global commodity, country-specific factors, such as tax structures, are particularly important factors in investment decisions, and the countries with the most competitive investment climates will be successful in attracting investment. BP believes a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax structure must be fair, stable and consistent for the entire business community.

With respect to your question regarding the relationship between after-tax profit and the price of oil, it is important to recognize that calculation of after-tax profits reflects the complex interplay of multiple factors, beyond the number of barrels produced, the price of oil per barrel, and national income tax. That after-tax information is confidential and proprietary, and disclosure of that information could cause competitive harm.

3. Some of the witnesses have testified that the oil and gas industry is already subject to high effective income tax rates. They refer to overall effective rates in excess of 40 percent. But these rates appear to be a weighted average of both U.S. and non-U.S. income tax rates applied to domestic and foreign earnings.

From financial reports filed with the SEC, it appears the effective U.S. income tax rates are significantly lower than the average foreign rates. It seems that the high foreign rates are pushing up the total reported effective rate. One of the companies stated in their financial disclosure that the weighted average statutory tax rate in countries in which they operate was 55.3 percent for 2010.

I would like to ask each of you what the U.S. tax rate is on just your U.S. income. And how does that compare to foreign tax rates you pay on your non-U.S. income?

So isn't the U.S. actually a favorable income tax environment in which to engage in production, refining and distribution?

And wouldn't that still be the case, even if these subsidies did not exist?

As an initial matter, it is important to recognize that comparing U.S. tax rates on U.S. income with foreign tax rates on non-U.S. income does not provide a meaningful picture of the structural factors that a company must take into account in making its investment decisions because it does not take into account factors beyond national income taxes, such as state taxes, or required expenses outside the tax realm, such as royalties and lease payments.

The tax rate BP pays in the United States on U.S. income (not including required payments to the government outside the tax code) begins with the 35% base U.S. corporate tax rate, less any Section 199 benefit for domestic production activities, plus applicable state income tax, which varies widely and can be quite significant. As an example, BP has significant operations in Alaska, where oil and gas net income is taxed at 9.4%. Since state income taxes are deductible for federal purposes, the effective overall rate is about 39%. That 39% rate, however, does not reflect the impact of state taxation, most notably state unitary taxation in jurisdictions, such as Alaska, that use that methodology. In 2010, for example, even though BP generated no domestic income, the company paid substantial state income tax in Alaska as a result of that state's worldwide unitary method of apportionment.

As to the rate BP plc pays on other foreign source income, the consolidated rate for 2010 is approximately 31% inclusive of U.S. operations and approximately 30.3% without U.S. operations.

Overall, BP believes a competitive and predictable tax structure is the best way to encourage continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax policy must be fair, stable and consistent for the entire business community. The tax framework and financial accounting system are factors that influence business and investment decisions. BP must make decisions about how to allocate its capital resources by considering a number of business factors.

4. **Current tax rules arguably allow foreign tax credits for payments that are economically equivalent to royalties.**

   The proposal under consideration would limit creditable foreign taxes to generally applicable foreign taxes.

   The three largest US oil companies are on pace to earn 80 billion dollars in aggregate profit in 2011. Making the proposed changes to the foreign tax credit rules would cost your companies less than one percent of that profit.

   Is it a serious problem for your company to pay less than 1% of your profits for the proposed modification?

The dual capacity taxpayer rules and regulations are designed to ensure that the correct foreign tax credit is applied in order to avoid double taxation of foreign income. This area of the tax code has consumed considerable legislative and regulatory attention over the years, and the current rules are already highly evolved to take into account the complexities of trying to ensure a fair tax regime that does not double-tax foreign income and therefore make the United States a less attractive place to invest. Introducing uncertainty into this well-settled area undermines the predictability of a tax structure that encourages potential investment.

5. **In 2005, the then-CEO of your company was a witness at a Energy and Natural Resources hearing regarding energy and prices and profits. At that hearing, the then-CEO of your company testified that these tax breaks would have a minimal impact on your company. When Americans are tightening their belts and some in Congress are proposing taking away benefits for senior citizens to reduce our deficit, why should we continue to spend scarce taxpayer resources on these tax breaks when the impacts for your company are so minimal?**

The subject of the 2005 Energy and Natural Resources hearing was the tax provisions of the 2005 energy bill, which included geological and geophysical (G&G) amortization changes and the refinery expensing provision. BP continues to believe that a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs.

QUESTION FROM SENATOR BAUCUS ON BEHALF OF SENATOR REID:

1. **How much did your company spend in 2010 in the US on the research, development, demonstration or domestic production of clean, non-petroleum-based alternative transportation fuels? Please also identify the amount by which that estimated expenditure was effectively reduced through Federal tax deductions or tax credits, such as the research and development tax credit, claimed by the company.**

BP spent $284 million on biofuels research, development, and demonstration in the United States in 2010. The information requested regarding the impact of applicable federal tax deductions or tax credits is confidential and proprietary and public disclosure of that information could cause competitive harm.

Properly scaled, transitional incentives for alternative energy encourage continued investment to increase the U.S. energy supply, including the supply of non-petroleum-based alternative transportation fuels. At the same time, to maintain the ability to meet growing energy demands in the United States, it is counterproductive to raise taxes on one form of energy to encourage production of another. In short, our nation's energy policy should encourage production of all forms of energy.

QUESTION FROM SENATOR WYDEN:

1. **When arguing for opening up US lands and waters for oil drilling, the oil industry complains that because most oil is controlled by foreign governments, the US oil industry has no place else to go for access to oil and gas resources except in the US. But at today's hearing, you testified that if you lost the tax breaks you currently receive, more oil exploration and production would go offshore.**

   How can you claim both that you have no place else to go to drill for oil outside the US and that if you lose tax breaks you'll move operations offshore? Isn't that a contradiction?

The majority of the world's oil reserves are, in fact, held by National Oil Companies. While this limits the amount of resource International Oil Companies may bid on and develop, BP has successfully partnered or created joint ventures in many countries to enable operations.

There are many factors that influence global investment. Open access to a resource base is clearly an important criterion in this equation. However, a country's underlying legal, tax and regulatory structures are also important in determining whether an area is attractive to investment.

Over the last decade, BP has disproportionately invested in the United States, committing nearly 50 percent of its capital budget in projects across the energy spectrum. Changing the tax structure in the United States would impact the relative competitiveness of the United States as a place to conduct business and could cause capital to flow to non-U.S. investment opportunities.

QUESTION FROM SENATOR THUNE:

2. **I want to discuss a particularly promising area of our country for domestic energy production, the Williston Basin located under parts of North Dakota, South Dakota, Montana and Canada. Some have called this area "Kuwait on the Prairie" because it holds the largest oil and gas find in North America since the Prudhoe Bay discovery in Alaska in the 1960s. Can you comment on the potential for job creation and economic development in the states I mentioned related to these oil and gas reserves. Would the tax increases in the President's budget and the legislation sponsored by Senator Menendez make you more or less likely to increase domestic production from these reserves, were these tax increases to be enacted into law?**

BP must make decisions about how to allocate its capital resources by considering a number of business factors in the context of the global competition for energy investment capital. Given that oil is a global commodity, country-specific factors, such as tax structures, are particularly important factors in investment decisions, and the countries with the most competitive investment climates will be successful in attracting investment. BP believes a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax structure must be fair, stable and consistent for the entire business community.

QUESTIONS FROM SENATOR ROCKEFELLER:

3. What was the average annual compensation for your company's top 5 executives over the past decade? Last year?

The table below reflects the average annual remuneration (salary, bonus, and non-cash benefits and other emoluments) of BP plc's top 5 executives in each year over the period 2003-2010, the period during which executive compensation has been publicly reported in BP's annual report. These figures exclude salary and/or other cash compensation paid to directors who retired or resigned during the reported years.

	2003	2004	2005	2006	2007	2008	2009	2010
Average Annual Remuneration (000 GBP)	1,506	1,612	1,429	1,111	1,488	1,959	2,166	957

4. What is the single most important tax incentive your business receives? Why?

BP must make decisions about how to allocate its capital resources by considering a number of business factors in the context of the global competition for energy investment capital. Given that oil is a global commodity, country-specific factors, such as tax structures, are particularly important factors in investment decisions, and the countries with the most competitive investment climates will be successful in attracting investment. BP believes a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax policy structure must be fair, stable and consistent for the entire business community.

BP does not believe the provisions at issue in S. 940 are properly characterized as tax subsidies for the oil and gas industry. Specifically, the LIFO rules are accounting rules that are applicable to many industries; the dual capacity taxpayer rules determine the amount of foreign tax credits based on distinguishing between tax payments and royalty payments; the § 199 deduction is the implementation of a policy connected to the creation of jobs and is not applicable only to the oil industry; and the Intangible Drilling Cost deduction is a cost recovery mechanism.

5. Two of your highest dollar tax incentives are Dual Capacity and Intangible Drilling Costs. Which of these two provisions is more important to your company and which you would choose to live without if Congress is forced to choose between the two?

The Intangible Drilling Costs (IDC) rules are a cost recovery mechanism for the industry similar to the R&D deduction, which is available to all industries. IDCs have allowed BP to reinvest in high paying jobs and create new technology such as that which allows us to develop new shale gas resources, while maintaining America's energy security.

The Dual Capacity regulations are not an "incentive" but instead are rules to ensure the foreign tax credit is accurately applied. The suggested changes could result in double taxation.

BP must make decisions about how to allocate its capital resources by considering a number of business factors in the context of the global competition for energy investment capital. Given that oil is a global commodity, country-specific factors, such as tax structures, are particularly important factors in investment decisions, and the countries with the most competitive investment climates will be successful in attracting investment. BP believes a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax structure must be fair, stable and consistent for the entire business community.

6. Some of you talk in your testimony of discriminatory treatment for your industry. It is my belief your industry has received preferred treatment for a century. Depletion goes back to 1916, and your industry was not eligible for the manufacturing subsidies that the section 199 subsidy replaced. Yet your companies' lobbying efforts allowed you to benefit from 199 when enacted. How do you reconcile such special treatment with claims of discrimination?

The deduction in 26 U.S.C. § 199 for income attributable to domestic production activities was established to help U.S. manufacturers maintain and create well-paying jobs. This deduction was established by Congress broadly to promote U.S. job creation across all industry, including agriculture, manufacturing, newspapers, software, and all extractive industries. Congress recognized the importance of the thousands of jobs in the domestic oil and natural gas industry and included petroleum extraction and refining within the United States as qualifying activities. To eliminate the § 199 deduction only for petroleum extraction and refining activities would be inappropriate and would undermine the industry's ability to continue to create well-paying U.S. jobs.

QUESTIONS FROM SENATOR ROBERTS:

7. **Understanding that the five companies appearing before us today are all publicly traded, and are about 98% owned by individuals or institutional investors who are managing pension funds, mutual funds and IRAs for millions of middle class Americans that rely on these holdings for their economic security and retirement; what impact do your companies' record profits this past year have on middle class Americans whose economic portfolios invest in U.S. integrated oil companies?**

Dividend payments to BP shareholders represent a return of earnings left over after reinvestment in the firm's future growth. Since 2000, BP has distributed approximately $120 billion to its shareholders: $70 billion in the form of cash dividend payments and $50 billion associated with share buybacks. At year end 2010, BP had over 430,000 registered shareholders worldwide, including individuals and institutional investors who are managing pension funds, mutual funds, and IRAs for millions of Americans.

8. **How significant of a role does certainty in tax policy play for your companies when making investments decisions regarding greater domestic production and, more importantly, when hiring new employees?**

BP must make decisions about how to allocate its capital resources by considering a number of business factors in the context of the global competition for energy investment capital. Given that oil is a global commodity, country-specific factors, such as tax structures, are particularly important factors in investment decisions, and the countries with the most competitive investment climates will be successful in attracting investment. BP believes a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax structure must be fair, stable and consistent for the entire business community.

Tax policy changes influence the amount of cash available to reinvest in our business. Over the five years ending in 2009, BP's total capital investment in the United States, not including acquisitions, was approximately $39.9 billion. Over the same period, BP's net income from the United States was approximately $27.5 billion. Policy changes that impose a greater tax burden will result in fewer resources available to invest in projects of all kinds, including oil, gas, and renewable energy sources like wind, biofuels, and solar.

QUESTIONS FROM SENATOR SNOWE:

9. **With prices as high as $100 the question today is whether our energy tax policies are effectively creating incentives to change behavior – rather than simply making cost-effective business decisions only more profitable.**

As a result, I find it interesting that in an analysis last year of the implications of removing these tax incentives that the American Petroleum Institute included an assumption that oil is at $80 per barrel. The analysis, done by Wood and Mackenzie, concluded that removing these tax incentives would alter the "breakeven" point for oil - that is the cost for profitability - from an average of $47.00 per barrel to $52.00 per barrel – or 10 percent.

In addition, the report's executive summary concludes that under scenarios where oil is higher than $80 the removal of oil and gas subsidies would not affect oil production at all. While I recognize that additional subsidies lead to additional production, it would seem that there would be decreasing returns from more and more subsidies for US oil production.

Specifically, while the report states concerns about the effects on natural gas production with the removal of subsidies the report states, "The impact to the oil market is much lower, as less than 60,000 barrels are at risk under the proposed changes in 2011." Effectively, the report concludes that if oil is priced at points higher than $80 per barrel the removal of these incentives will not result in any lost oil production.

At a time when oil is priced at roughly $100 – and if these prices were to continue – do you agree with the API report that there would not be any reduced production of oil in the United States if the tax incentives were removed?

Do you support removing these tax subsidies for oil at a certain point, perhaps the long-term level that EIA or your companies predict that oil will be in 5-10 years?

BP does not believe the provisions at issue in S. 940 are properly characterized as tax "subsidies" for the oil and gas industry. Specifically, the LIFO rules are accounting rules that are used by many industries; the dual capacity taxpayer rules determine the amount of foreign tax credits based on distinguishing between tax payments and royalty payments; the § 199 deduction is the implementation of a policy connected to the creation of jobs and is not applicable only to the oil industry; and the Intangible Drilling Cost deduction is a cost recovery mechanism.

The Wood Mackenzie analysis cited in the question looked at planned projects and fields that were known by them to be moving forward. It was not an analysis of existing production, but existing or known plans to produce.

BP must make decisions about how to allocate its capital resources by considering a number of business factors in the context of the global competition for energy investment capital. Given that oil is a global commodity, country-specific factors, such as tax structures, are particularly important factors in investment decisions, and the countries with the most competitive investment climates will be successful in attracting investment. BP believes a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax structure must be fair, stable and consistent for the entire business community.

10. We have witnessed the continued volatility of our energy futures markets, with for instance gasoline prices falling 7.6 percent on May 11th, 2011, coming during a year when gasoline has increased by more than 28 percent. The development yesterday came when the U.S. Department of Energy surprised traders by reporting an unexpected buildup of gasoline stockpiles in the previous week.

This situation yesterday raises two critical questions regarding the efficiency of our energy markets. First, as the Commodity Futures Trading Commission is considering now, should we adopt position limits for particular traders to reduce the volatility of specific contracts. As a leader, along with Senators Feinstein and Cantwell, on developing a strong derivative title within the financial reform bill, I strongly believe transparency and restrictions on specific trades will not restrict price discovery, but will reduce volatility and potential for manipulation.

Secondly, trading on May 11th again demonstrates how critical it is for an efficient market to have access to accurate and timely data. This is not like any other market – information regarding consumption, production, and reserves are controlled, in some instances, by America's adversaries.

For instance, just last month the Wall Street Journal reported that "unreliable data on production, starting with the world's largest exporter, are adding to the price volatility..." and that the "revelation highlighted a problem that is roiling markets at the moment: a dearth of solid information about the true state of production and supplies."

As a result of these developments do you believe that the CFTC should adopt strict position limits for speculative traders and do you believe that there is enough transparency in these markets to accurately assess efficient pricing of oil?

Do you believe that current prices are reflective of supply and demand?

Do you believe that foreign countries are doing enough to supply the world with information about reserves and production and what can the United State government do to facilitate information sharing?

Commodity prices are largely driven by global supply/demand balances. Regional events can have an effect as well. Recently, for example, we have seen supply disruptions due to political upheaval in producer regions that may have contributed to temporary price dislocations.

The industry has operated with position limits for commercial and non-commercial entities as defined by the Commodity Exchange Act. Appropriate position limits have contributed to orderly market participation. The CFTC Commitment of Traders report provides further transparency around market participation.

Liquidity and transparency are important factors in price discovery, which allows markets to operate efficiently. BP has supported the cause for transparent energy market data via its annual Statistical Review of World Energy, which is publicly available. There are a number of other sources available to assess supply and demand balances, such as the Energy Information Administration, the U.S. Department of Energy, and the International Energy Agency.

11. The Tax Reform Act of 1986 is constantly referred to as a model for tax reform and the point often made any new reform we undertake should follow its lead, which was to broaden the base and to reduce tax rates. The phrase "broaden the base" is just a clever way of saying "eliminate tax provisions" such as credits and deductions that clutter the code in order to simplify the code and to provide the revenue needed to offset the corresponding reduction in tax rates.

The Democrats have presented us with an opportunity to broaden the base by eliminating certain tax provisions, namely, the tax benefits that are available currently to the five companies before us today. But instead of lowering the rates, the plan is to use the revenue from these cuts to pay down the deficit – just another way avoiding the spending cuts that the American people recognize has led us to these deficits.

The Finance Committee has held a series of tax reform hearings and I thank Chairman Baucus for that. One thing we have learned is that the tax code is filled with too many special provisions and today we are debating yet one more complication to a tax code that is screaming for simplification.

What we should be pursuing is a comprehensive energy plan at the same time we pursue comprehensive tax reform. There is wide agreement that the rates are too high for our American companies to remain competitive – even the Obama Administration has suggested cutting corporate tax rates. We could start to do so today, with a down-payment made on such rate reductions by the elimination of the oil and gas provisions currently on the table.

We have to ensure the competitiveness of American companies and cutting the tax rate is one goal where we already have some consensus. We just need to agree on how to get there. Do you agree that reducing tax rates would justify the elimination of the oil and gas tax provisions we are discussing today? Do you think that rather than stop with these oil and gas provisions, we should also eliminate other energy subsidies in order to provide the broadest possible rate reductions?

Determination of tax policy is up to Congress, but BP wants to participate in the dialogue on the important issues of comprehensive tax reform and deficit reduction. BP believes that it is important that tax reform be undertaken as a comprehensive effort that results in the U.S. tax system's being competitive. In that regard, we do not support proposals that target one industry to provide revenue for deficit reduction.

QUESTION FROM SENATOR ENZI:

12. **You all indicated that you were in favor of overall corporate tax reform. In that regard, I have three questions:**
    If Congress were to take up corporate income tax reform and eliminate provisions of the tax code that benefit traditional and alternative energy industries, to what rate would the corporate income tax need to be lowered to avoid a net tax increase on your company?

    While I support the ideas of individual and corporate tax reform, I am concerned that a dramatic change in our tax code will be problematic for companies and individuals who have done long term tax planning. Do you agree with my assessment that there needs to be a phase in period? If so, how long should that phase in period be? If not, please explain how your company would handle such a change in the tax code.

    Are there any provisions of the tax code that you would prefer not be changed if we were to lower the corporate tax rate as a part of overall corporate tax reform?

BP believes it is important that tax reform be undertaken as a comprehensive effort that results in the U.S. tax system being competitive. It should include consideration of all issues for all industries. A reduction in the corporate tax rate would need to drop the rate to at least the mid-20's in order to be competitive in the global economy.

Transitional rules for all changes included in comprehensive tax reform should be considered and may be appropriate and necessary for some changes in order to allow businesses to adapt to the changes for planning purposes. The length of any necessary phase-in periods will likely vary depending on the rule changes, so it will be important for business to be part of the discussion, as the process advances, about the impact on investments and operations.

QUESTIONS FROM SENATOR CANTWELL:

13. **The discussion of tax subsidies and incentives in the May 12, 2011 Finance Committee hearing was largely an abstract one on the overall economic and societal costs and benefits that result from these measures. I would appreciate having more specific information on the extent to which your firms have benefited from the tax provisions being discussed over the last decade. For your respective firms, would you please provide auditable data on your company's utilization of each of the following categories and for each of the past ten years (2000-2010):**

    - **Enhanced Oil Recovery Credit**
    - **Credit for Oil and Gas from Marginal Wells**
    - **Expensing of Intangible Drilling Costs**
    - **Deduction for Tertiary Injectants**
    - **Passive Loss Exception for Working Interests in Oil Properties**

- **Percentage Depletion for Oil and Natural Gas Wells**
- **Domestic Manufacturing Deduction for Oil and Natural Gas Companies**
- **Geological and Geophysical Amortization**
- **Net annual profit**

Audited financial data for BP plc can be found on Form 20-F, which is filed annually with the Securities and Exchange Commission. The information requested regarding utilization of specific tax code provisions is confidential and proprietary, and public disclosure of that information could cause competitive harm.

14. **I think we can all agree that America's future prosperity and competitiveness is contingent on figuring out how we can live within our means while providing our businesses more predictability and stability in the marketplace, in part by providing a more level playing field for all market participants. I would argue that one thing we can do is to ensure that U.S. industries all receive equal treatment under the federal tax code so that they operate on an equal footing. I don't understand, for example, why oil companies should be allowed to write off the costs of machinery and other so-called "intangible costs" immediately, while companies in other industries have to write off these expenses gradually, over the lifetime of the equipment they purchase. Likewise, a few years ago, Congress to redefine the word "manufacturing" so that oil companies could take advantage of a manufacturing tax deduction for oil production.**

    I was intrigued by an argument that Mr. Watson made in his testimony, which if I understood him correctly, argued that we should not change tax breaks for the oil industry outside of a broader context of corporate tax reform.

    Does that mean that you might all be willing to work with Congress to figure out ways to simplify and reform our nation's byzantine tax code in the interest of replacing the myriad of tax expenditures we are discussing here today with lower overall corporate tax rates for all industries?

BP wants to be part of the debate on comprehensive tax reform and desires to work with Congress on this issue. We believe that it is important that tax reform be undertaken as a comprehensive effort that results in the U.S. tax system being competitive. It should include consideration of all issues for all industries.

15. **Considering all the uncertainties that affect your industry and the United States as a whole, would you support efforts to create a policy framework which provides greater certainty and stability when it comes to energy prices, regulation, and supply and demand fundamentals? I believe that is an important question because eventually Congress will regulate greenhouse gas emissions. This moment may come as soon as next year if the DC Circuit throws out EPA's tailoring rule. Would your companies support be supportive of legislation that established a price on carbon in a manner that was transparent, market-based, technology and fuel neutral, and economy-wide, as an alternative to EPA regulation of greenhouse gases?**

BP supports a comprehensive climate and energy policy that includes development of all forms of energy (oil, natural gas, coal, nuclear, biofuels, wind, solar, etc.) and encourages efficiency and conservation.

BP also supports an economy-wide price for carbon based on fair and equitable application across all sectors and believes that market-based solutions are the best solutions to manage greenhouse gas emissions. These market-based approaches should be applied nationally for maximum environmental effectiveness at reducing emissions across the U.S. economy, treat all energy consumers equitably, and facilitate investment in sustaining and creating jobs.

16. **Both the Joint Economic Committee and the Congressional Research Service produced analyses that show that removing tax expenditures to the oil industry as proposed in S. 940 will [not] lead to significant gasoline price increases or oil production decreases. To you agree with conclusions of these reports? And if not, please describe in detail the flaw or flaws in their analyses. Are there any independent studies that demonstrate that eliminating these tax expenditures will significantly increase prices or reduce domestic oil and gas production?**

There is a global competition for investment capital in the energy business – the countries with the most competitive investment climates tend to succeed in attracting investment. Accordingly, policy changes that make the U.S. investment regime less competitive would be expected to reduce investment in the United States and ultimately lead to lower production than otherwise would have been the case. Estimating the price impact of any such change is difficult because of the many compensating behaviors by producers and consumers, but holding all other factors constant, if such policies resulted in lower global oil production, they would be expected to boost world (and U.S.) oil prices.

17. **In your opening statement you stated that "[o]n the supply side, we support properly scaled transitional incentives for alternative energy. But raising taxes on form of energy to encourage production of another will reduce industry's ability to keep up with growing U.S. energy demand." How do you define the term "properly scaled transitional incentive?"**

    Does it relate to the duration of the provision? Or, does it relate to the value of the subsidy in terms of leveling the playing field across all forms of, as you said, "all forms of energy including oil and natural gas."

    How do we measure whether an incentive has done its job and has served its intended purpose? And if we decide that "properly scaled transitional incentives for alternative energy" are not needed anymore, do you think we would be "raising taxes" on alternative energy production?

The primary goal of a transitional incentive is to reduce the costs of emerging technologies to a level that allows those technologies to compete in the market. Allowing multiple firms to compete with one another and deploy new technology at scale yields various innovations along the supply chain that combine to reduce costs. Due to the global support for alternative energy technology through tax support and renewable mandates, for example, we have already observed significant reductions in the cost of wind and solar technology and improvements in productivity. Because they are a means to an end, such incentives should be temporary (transitional), lasting no longer than is necessary to achieve the objective.

From BP's perspective, a "properly scaled" incentive is one that allows deployment and operation at commercial scale (as opposed to small test pilot projects) by multiple firms competing in an open market with exposure to market conditions and investment risk.

There needs to be sufficient duration to allow the firms to adapt new technologies and build upon the series of innovations in the market. And the goal of the deployment should be for the technology to compete with all forms of energy without subsidy. In this case, renewable technology will need to compete primarily with power produced from coal and natural gas. Removing tax incentives or gradually reducing the level of support (similar to the designed and scheduled reductions in feed-in tariffs in Germany) recognizes that the technology is capable of competing. This is most appropriately characterized as a successful outcome of policy rather than a "tax increase."

18. You said in your opening statement, "Because of the long term nature of the significant capital investments that are required to develop and produce energy, a stable and competitive tax framework is critical to the United States' remaining attractive in the global demand for capital investment." I agree, but I would like to know how you square this call for stability in the tax system with the notion of "transitional incentive," which you suggest should apply only to alternative forms of energy?

Since your company also invests in alternative energy technologies, do you also claim the tax subsidies that are provided to encourage those investments? Should we give those subsidies the same long-lived stability in the tax code that the oil and gas industry subsidies have had? If not, do you think should we reconsider how we use the tax code as an energy policy tool, perhaps to remove all distinctions between the tax treatment of traditional energy companies and new energy companies?

BP has made significant investments in alternative energy technologies that have been encouraged by tax support and non-tax measures, such as renewable energy mandates (and in Europe, feed-in tariffs). The duration and stability of these tax and non-tax incentives is important to the development of technology as it allows any firm to build upon innovations emerging from the supply chain. Abrupt changes in support or the risk that support will not be renewed will discourage long-term investment required for these innovations to emerge.

The benefits of a stable and predictable tax code are not unique to renewable energy technology. Any energy technology or source can benefit (or be penalized) by economic incentives built into the tax code.

The U.S. tax code can be used as an effective policy tool to encourage a range of policy objectives: increased domestic production of all energy; development of new energy technology, including advanced drilling technology and low-carbon energy production; and energy efficiency and conservation. The tax code can be supplemented by well-designed mandates or performance standards. In any case, a clear policy objective supported by stable and predictable measures will encourage robust and long-term investment.

QUESTIONS FROM SENATOR MENENDEZ:

19. **According to the Energy Information Administration, the average cost to produce a barrel of oil is around $33; but SEC filings show that the average production costs for the Big 5 are much lower, at about $11. With a barrel of oil selling for around $100, why do you need subsidies? Can each of you tell the Committee and the American people what price per barrel and profit margin you will need to reach before these subsidies are no longer necessary?**

BP must make decisions about how to allocate its capital resources by considering a number of business factors in the context of the global competition for energy investment capital. Given that oil is a global commodity, country-specific factors, such as tax structures, are particularly important factors in investment decisions, and the countries with the most competitive investment climates will be successful in attracting investment. BP believes a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax structure must be fair, stable and consistent for the entire business community.

20. **Please provide a detailed accounting of how many dollars your company did not pay in taxes as a result of the tax subsidies proposed to be eliminated in S.940, the Close Big Oil Tax Loopholes Act, for each of the last 5 years.**

As an initial matter, BP does not believe the provisions at issue in S. 940 are properly characterized as tax "subsidies" for the oil and gas industry. Specifically, the LIFO rules are accounting rules that are applicable to many industries; the dual capacity taxpayer rules determine the amount of foreign tax credits based on distinguishing between tax payments and royalty payments; the § 199 deduction is the implementation of a policy connected to the creation of jobs and is not applicable only to the oil industry; and the Intangible Drilling Cost deduction is a cost recovery mechanism. The information requested regarding utilization of specific tax code provisions is confidential and proprietary, and public disclosure of that information could cause competitive harm.

POST-HEARING QUESTIONS FOR THE RECORD
UNITED STATES SENATE COMMITTEE ON FINANCE
MR. H. LAMAR MCKAY, CHAIRMAN AND PRESIDENT, BP AMERICA, INC.
"OIL AND GAS TAX INCENTIVES AND RISING ENERGY PRICES"
HEARING HELD ON MAY 12, 2011
QUESTIONS DATED JUNE 30, 2011

ANSWER SET

AUGUST 5, 2011

QUESTIONS FROM SENATOR COBURN:

1. **In light of the budget crisis our country faces, would your company be willing to take a cut to help the country?**

BP wants to be part of the debate on comprehensive tax reform and desires to work with Congress on this issue. We believe that it is important that tax reform be undertaken as a comprehensive effort that results in the U.S. tax system's being competitive. It should include consideration of all issues for all industries.

2. **Would you be willing to forgo each of the industry's tax advantages altogether if the following were true:**
   - **A. federal assistance for alternative energy was also eliminated to ensure true competition among technologies;**
   - **B. the corporate tax rate for all industries was reduced to establish a competitive business environment;**
   - **C. energy companies were allowed to fully access our nation's extensive natural resource deposits-including in ANWR, the Outer Continental Shelf, the Gulf of Mexico, and the various shale plays across the country;**
   - **D. the regulatory process for energy leasing was streamlined-particularly as it relates to environmental permitting?**

As stated above, BP wants to be part of the debate on comprehensive tax reform and desires to work with Congress on this issue. We believe that it is important that tax reform be undertaken as a comprehensive effort that results in the U.S. tax system's being competitive. It should include consideration of all issues for all industries.

3. **The American Petroleum Institute estimates the 9.2 million employees in the oil and gas industry earn over $90,000 per year (upstream and downstream job average---not including retail station sales). One of the nation's largest independents employing over 5,000 pays its employees: (1) $176,000 per year for engineers, geologists, etc.; (2) $138,000 per year for professional staff, such as accountants, human resources, etc.; and (3) $52,000 per year for clerical and administrative staff.**

   What is the average salary for your employees?

The average base salary for BP employees is approximately $108,000. This figure does not include variable forms of compensation for which employees may be eligible. As your question reflects, the oil and natural gas industry provides higher-than-average wages to American workers.

4. What are the three things Congress can do to lower gas prices?

Crude oil prices are by far the most important driver of gasoline prices. Changes in supply and demand -- and changing expectations of future supply and demand -- affect oil prices. To help increase supply, Congress can pursue policies that allow for the responsible development of domestic resources and foster a climate of innovation to drive down costs for abundant domestic supplies such as unconventional and new sources; it can also pursue policies to encourage the more efficient consumption and storage of energy. Further, Congress can support policies abroad to extend the reach of market forces.

5. What was your effective tax rate last year?

BP plc's effective tax rate for 2010 was 31.6%. BP plc's effective tax rate for 2004-09 was 34.1%.

6. What is your total tax benefit that you receive from the provisions targeted by recent proposals to eliminate existing tax advantages for your company?

BP does not believe the provisions at issue in S. 940 are properly characterized as tax "advantages" for the oil and gas industry. Specifically, the LIFO rules are accounting rules that are applicable to many industries; the dual capacity taxpayer rules helped to distinguish tax payments from royalty payments when calculating a taxpayer's foreign tax credits; the § 199 deduction is the implementation of a policy connected to the creation of jobs and is not applicable only to the oil industry; and the Intangible Drilling Cost deduction is a cost recovery mechanism. The information requested regarding utilization of specific tax code provisions is confidential and proprietary, and public disclosure of that information could cause competitive harm.

QUESTIONS FROM SENATOR CORNYN:

Taxing Domestic Producers

1. Has there been any analysis done on how these domestic energy tax hikes would impact the 9.2 million jobs that the industry supports? Can you tell the Committee what it will mean to your operations?

BP is aware of various studies on the impact of tax changes on jobs in the oil and gas industry, including that of Dr. Joseph R. Mason (the Hermann Moyse, Jr./Louisiana Bankers Association Professor of Finance at Louisiana State University and Senior Fellow, the Wharton School), published on July 12, 2011 and entitled "Budget Impasse Hinges on Confusion among Deficit Reduction, Tax Increase, and Tax Reform: An Economic Analysis of Dual Capacity and

Section 199 Proposals for the U.S. Oil and Gas Industry." Dr. Mason estimated that "proposed revisions to Section 199 and Dual Capacity for the oil and gas industry" will result in "industry cutbacks that can reasonably be expected to cost the economy some $341 billion in economic output, 155,000 jobs, $68 billion in wages, and $83.5 billion in reduced tax revenues."

Like all in energy companies, BP must make decisions about how to allocate its capital resources by considering a number of business factors in the context of the global competition for energy investment capital. Given that oil is a global commodity, country-specific factors, such as tax structures, are particularly important in investment decisions, and the countries with the most competitive investment climates tend to be successful in attracting investment. BP believes a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax structure must be fair, stable and consistent for the entire business community.

The deduction in 26 U.S.C. § 199 for income attributable to domestic production activities was established to help U.S. manufacturers maintain and create well-paying jobs. This deduction was established by Congress broadly to promote U.S. job creation across all industry, including agriculture, manufacturing, newspapers, software, and all extractive industries. Congress recognized the importance of the thousands of jobs in the domestic oil and natural gas industry and included petroleum extraction and refining within the United States as qualifying activities. To eliminate the § 199 deduction only for petroleum extraction and refining activities would inappropriately single out the oil and gas industry and would undermine the industry's ability to continue to create well-paying U.S. jobs.

The Intangible Drilling Costs (IDC) rules are a cost recovery mechanism for the industry similar to the R&D deduction, which is available to all industries. IDCs have allowed the industry to reinvest in high-paying jobs and to create new technology, such as that which allows the development of new shale gas resources, while maintaining America's energy security. The dual capacity regulations are rules to ensure that the foreign tax credit is accurately applied. The suggested changes could result in double taxation.

2. How does U.S. tax policy influence company decisions to invest in the United States to develop new energy sources?

As stated above, like all energy companies, BP must make decisions about how to allocate its capital resources by considering a number of business factors in the context of the global competition for energy investment capital. Given that oil is a global commodity, country-specific factors, such as tax structures, are particularly important in investment decisions, and the countries with the most competitive investment climates tend to be successful in attracting investment. BP believes a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax structure must be fair, stable and consistent for the entire business community.

Tax policy changes influence the amount of cash available to reinvest in our business. Over the five years ending in 2009, BP's total capital investment in the United States, not including acquisitions, was approximately $39.9 billion. Over the same period, BP's net income from the United States was approximately $27.5 billion. Policy changes that impose a greater tax burden will result in fewer resources available to invest in projects of all kinds, including oil, gas, and renewable energy sources like wind and biofuels.

3. Would you support a review of all business and individual tax provisions in the context of broad tax policy reform?

BP wants to be part of the debate on comprehensive tax reform and desires to work with Congress on this issue. We believe that it is important that tax reform be undertaken as a comprehensive effort that results in the U.S. tax system's being competitive. It should include consideration of all issues for all industries.

Revenue to the Treasury

1. What amount have your companies spent in terms of bonus bids for lease sales and royalties going to the Treasury?

BP has spent approximately $4.5 billion in bonus bids for lease sales and royalties paid directly to the Treasury since 2005, and, in addition, provided an estimated $3.5 billion of royalties in kind, which are in the form of oil or gas production rather than cash. These figures do not include royalties from Native American lands.

Helping OPEC

1. Is the U.S., relative to other countries, a high cost place to conduct oil and gas operations?

The U.S. Energy Information Agency reported that the United States had higher lifting (production) costs and finding costs than the worldwide average in 2009 (the last year data is currently available).

Alternative Energy Production

1. How will tax increases as proposed in S. 940, impact your companies' investments in alternative energy?

BP has made significant investments in alternative energy technologies that have been encouraged by tax support and non-tax measures, such as renewable energy mandates. The duration and stability of these tax and non-tax incentives is important to the development of technology as it allows any firm to build upon innovations emerging from the supply chain. Abrupt changes in support or the risk that support will not be renewed will discourage long-term investment required for these innovations to emerge. The U.S. tax code can be used as an effective policy tool to encourage a range of policy objectives: increased domestic production of

all energy; development of new energy technology, including advanced drilling technology and low-carbon energy production; and energy efficiency and conservation.

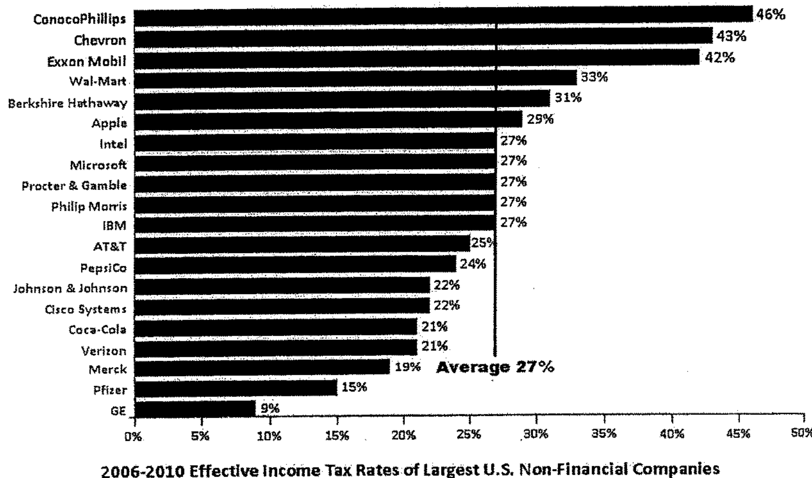
As stated above, like all energy companies, BP must make decisions about how to allocate its capital resources by considering a number of business factors in the context of the global competition for energy investment capital. Given that oil is a global commodity, country-specific factors, such as tax structures, are particularly important in investment decisions, and the countries with the most competitive investment climates tend to be successful in attracting investment. BP believes a competitive and predictable tax structure is an important element of encouraging continued investment to increase U.S. energy supply and create U.S. jobs. In order to attract investment in the United States, an effective tax structure must be fair, stable and consistent for the entire business community.

Written Testimony of James J. Mulva
Chairman and Chief Executive Officer, ConocoPhillips

Good morning Chairman Baucus, Ranking Member Hatch and members of the Committee. My name is James J. Mulva. I am Chairman and Chief Executive Officer of ConocoPhillips. I am particularly pleased to be here today to tell our side of the story in this important debate, which I believe will help shape the future of our industry and our country. Naturally, I am very concerned about the misinformation being circulated about our industry and my company in particular – especially the misinformation surrounding our corporate tax liabilities and attempts to use these false impressions to justify further increases in our company's tax burden. I feel that it is imperative to make you aware of the impacts that the tax proposals will have, not only on our company, but on American jobs, energy consumers and national energy security.

While there is much discussion about high energy prices and proposals to increase taxes on oil and natural gas companies like ConocoPhillips, there seems to be far less information about the rest of the story -- how much we pay already in taxes. As depicted in this chart, our industry already has one of

U.S. Energy Companies Are Already Heavily Taxed



2006-2010 Effective Income Tax Rates of Largest U.S. Non-Financial Companies

Source: Bloomberg, calculated as financial tax divided by pre-tax income, Top 20 of Fortune 500 companies by market cap, excludes financial institutions.
Fiscal year-end dates differ by company.
2008 ConocoPhillips earnings adjusted for write-down of goodwill and LUKOIL investment ($32.9B); effective tax rate, including these items, was 66% for the five-year period.

the highest tax rates among all U.S.-based businesses. Of the top 20 Fortune 500 non-financial companies (ranked by market capitalization), the three U.S.-based oil and gas companies represented here today are the top taxpayers on the list. In fact, ConocoPhillips tops the entire list, with a 46 percent effective tax rate. By comparison, the top 20 companies together pay an average effective rate of 27 percent. While there have been some media reports on our industry's actual tax burden, this fact seems to be consistently and unfortunately overlooked in the debate inside the Beltway.

The Obama Administration, in its 2012 Budget Proposal, recommended more than $40 billion in tax increases over the next 10 years, specifically aimed at the oil and natural gas industry. The Administration has further proposed other tax increases which would cost the industry an additional estimated $50 billion over the ten-year period. The hyperbole surrounding this debate typically consists of those who would raise our taxes describing all these items as oil and gas tax "subsidies" or "loopholes" or other such characterizations. Many in Washington and beyond have chosen to use this language and accept, as a foregone conclusion it would seem, that tax deductions or credits when used by an oil or natural gas producer must automatically be characterized as tax subsidies; even when these deductions or credits apply well beyond the industry and are widely available to a broad range of other businesses and industries. These mischaracterizations do nothing to inform the public of the true nature of the issues. Worse yet, they fuel the misinformation that precludes a responsible debate on the issues.

Tax Reform and the Broader Debate

Before moving to the specifics of the various tax issues, I would like to comment on the process of tax reform. We believe that the U.S. corporate tax system can and should be improved. It is widely recognized that the United States has one of the world's highest corporate tax rates – both when comparing marginal and effective tax rates. The U.S. system is overly complex and is designed to play favorites among industries, activities, taxpayers and special interests. It is my hope that, by describing the tax items applicable to our industry and pointing out that, when the dust has settled, we pay higher tax rates across the board than any other industry, it will become clear that we are already highly taxed and should not be targeted for further increases that will only threaten jobs and national energy security. It is my further hope that the members of the Senate Finance Committee, who are charged with responsibility for developing sound and rational tax policy for our country, will see through the rhetoric and get it right.

In short, large oil and natural gas producers like ConocoPhillips do not get special tax subsidies. The items identified as "subsidies" to oil and natural gas companies either: a) are not applicable to the largest producers, like ConocoPhillips; or b) are not limited to oil and natural gas companies, but are widely available to all U.S. manufacturers and producers. These hardly sound like "special industry subsidies" to me.

Specific Provisions of Concern

My submission will focus upon those tax issues of greatest importance to ConocoPhillips, whether or not they are identified as "oil and gas tax" items. Those items, followed by a more detailed discussion of each, are as follows:

Dual Capacity Taxpayer Rules.
The pending modification to the dual capacity taxpayer rules, which has been proposed multiple times in the past, and which we understand is currently under consideration again in the Senate, is a proposal to impose double taxation on the income of oil and natural gas companies. This provision would change the way in which U.S.-based oil and natural gas companies treat taxes paid to foreign governments, under the foreign tax credit rules of the Internal Revenue Code. It is important to note that this provision, as currently being considered, would ONLY have a material tax impact on the three U.S.-based firms appearing today (ConocoPhillips, ExxonMobil and Chevron). These proposed additional restrictions to the foreign tax credit rules for energy companies would render U.S.-based companies less competitive in the global market, at a time when we are already competing every day against national oil companies and other non-U.S. companies for critical resources. This provision will result in lost opportunities around the globe and lost jobs here in the U.S. As we lose projects and opportunities to foreign competitors, many of those jobs will necessarily disappear. These foreign tax credit restrictions may well result in a reduction in overall investment in U.S. energy production, transportation and refining. But the real impact will be that future investment by U.S. firms, which provide and support a proportionately greater number of domestic

jobs than foreign competitors do, will be significantly reduced. In fact, we believe that this provision alone will substantially increase the level of foreign investment in the U.S. oil and gas sector, because U.S. companies will be heavily penalized by this provision, while their foreign competitors will not. For companies based in Europe, Asia or elsewhere, this provision will not impose an additional tax burden on their investment of funds in U.S.-located projects.

Some of the facts about the dual capacity and foreign tax credit rules follow:

- The current rules for dual capacity taxpayers already serve as a restriction or limitation on U.S.-based oil and natural gas companies' ability to claim foreign tax credits (FTCs) for foreign taxes paid. These rules provide a strict regime for determining whether a foreign payment constitutes a payment of income tax (which is creditable), or another type of payment, e.g., a royalty (which is not creditable). Contrary to erroneous assertions that U.S. oil and natural gas companies received foreign tax credits for "royalty payments," the existing tax rules specifically prohibit us from claiming FTCs for such payments.
- All other U.S. industries and companies that earn income in foreign countries may claim FTCs on their tax returns, yet they do not face the same existing limitations currently in place for dual capacity taxpayers.
- Our company is under constant audit by the Internal Revenue Service, which vigorously reviews these payments to determine whether they are properly reported under the law.
- Dual capacity taxpayer provisions have never been identified by the Joint Committee on Taxation as a "tax expenditure," which means that the Joint Committee does not consider these provisions to be a subsidy.

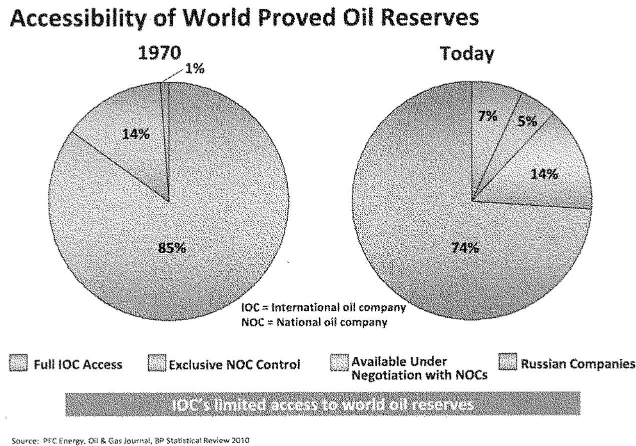
Some facts about our foreign income and tax credit positions:

- ConocoPhillips has a U.S. work force of approximately 20,000 people, and we estimate that about 3,000 of these U.S. jobs exist to support our international operations.
- Among the companies at this hearing, ConocoPhillips has the largest U.S. domestic presence, as a percentage of our total investment portfolio.
- In spite of that, ConocoPhillips still earns approximately 60 percent of its income outside the United States.
- ConocoPhillips returns virtually all of that income to the United States to help fund its capital investment programs, both here and overseas. This is contrary to the practices of many U.S. multinational companies in other industries, which are heavily incentivized to leave foreign earnings overseas in order to avoid the onerous additional burden of U.S. tax on that income.
- Some in Washington are proposing a "tax holiday" on foreign earnings, which would allow U.S. companies to return their profits to the United States at a lower-than-normal tax rate, to provide an incentive to bring those earnings home. While we understand the interest in such a provision, we would not benefit since we already bring our earnings home.
- The proposed changes to our foreign tax credits will mean that we would be penalized for bringing our profits home. So rather than spending those profits on job creation, reinvestment and returns to shareholders (actions otherwise recognized as contributing to U.S. economic growth), we will face the dilemma of leaving those earnings overseas or paying dramatically higher taxes on them.
- The fact that some foreign countries may possibly have lower taxes is not a primary factor in determining where we choose to operate. We must go where oil and natural gas exist. From a tax perspective, it would be attractive to produce hydrocarbons in low-or-no-tax jurisdictions, but such places don't have much oil and natural gas, so we're not drilling in them.

Typically, we pay foreign taxes at rates equal to or in some cases above the U.S. tax rate. Some would argue that because it is common for producing countries to charge oil and natural gas companies higher tax rates than other industries, that the portion above the general tax rate must not be a tax at all, but a payment for some form of benefit, such as a royalty. On that point, the Joint Committee on Taxation agrees with us that such an argument doesn't stand up under the facts. The Joint Committee's description of the dual capacity taxpayer proposal contained in the Administration's Budget Proposal for Fiscal Year 2011 states:

Furthermore, a fundamental assumption behind the proposal, that countries generally seek to impose an equal tax burden on all taxpayers and therefore any additional tax burden imposed solely on dual-capacity taxpayers reflects payment for a specific economic benefit, is arguably incorrect. Taxing jurisdictions often impose different levels of tax burden on different industries according to various factors including the relative mobility of a particular industry. [Footnote omitted.] A taxpayer in a relatively immobile industry, such as a company engaged in a natural resource extraction industry, is compelled to operate within the natural resource's jurisdiction notwithstanding a relatively high tax rate.[1]

Gaining access to resources around the world has become increasingly challenging, due in large part to the rising role of national oil companies (NOCs). In this environment, international oil companies (IOCs) find it increasingly difficult to compete for access to critical resources. A recent study has shown that U.S.-based companies are particularly challenged, due in part to the already-existing limitations imposed by the U.S. tax system.[2] The charts below help illustrate just how unfavorably the landscape has changed for IOCs in the competition for resources. From having full access to 85 percent of world resources in 1970, they can now directly access only 7 percent.

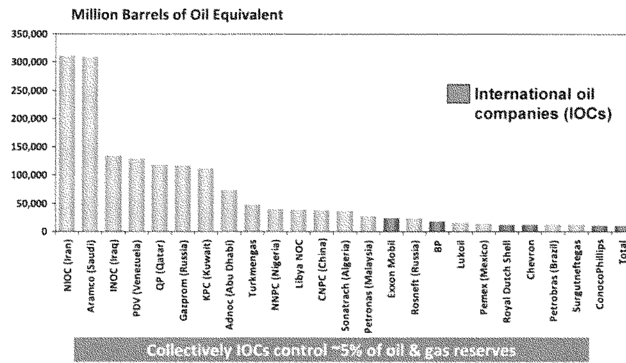


Additionally, the next chart shows the massive scale of the NOCs, some of which are a dozen times larger than the IOCs in terms of hydrocarbon reserves. The NOCs include such massive entities as the National Iranian Oil Company, Saudi Aramco, Petroleos de Venezuela SA (PDVSA) and a number of others.

---

[1] Joint Committee on Taxation, *Description of Revenue Provisions Contained in the President's Fiscal Year 2011 Budget Proposal*, Page 319.

[2] *Fiscal Fitness, How Taxes at Home Help Determine Competitiveness Abroad,* 2010 HIS CERA, Inc., Page 4.



As the role of NOCs in global markets increases, additional impediments to the ability of U.S.-based IOCs to compete, in the form of modifications to the dual capacity rules, will only exacerbate this problem, further threatening U.S. jobs and energy security.[3] In summary, this proposal would:

- Destroy high-paying U.S. jobs;
- Hand over to foreign interests an even greater share of America's energy investment and national security;
- Punish domestic oil and gas companies for returning their profits to the U.S.; and
- Reduce overall investment in energy production at a time when we need more, not less energy.

Section 199 Deduction for Domestic Production Activity.
Current and proposed legislation, along with the Administration's Budget Proposal for the 2012 fiscal year, would eliminate the tax deduction provided by Section 199 of the Internal Revenue Code for oil and gas companies. In some cases, only the five largest oil and natural gas companies operating in the United States would be subject to this elimination. Section 199 is consistently and erroneously identified as one of the so-called "oil and gas tax subsidies," as part of efforts to raise taxes on the industry.

The truth is that the Section 199 deduction is available to all U.S. producers and manufacturers, and is not limited to oil and natural gas producers, although efforts to repeal the provision seem to have targeted this industry alone. Another fact regarding this provision is that oil and natural gas producers are already limited in their ability to claim this deduction, compared to other domestic industries. Although the deduction under Section 199 is generally calculated as 9 percent of domestic production income,[4] oil and

---

[3] Economic and Foreign Policy Implications of the Administration's Dual Capacity Taxpayer Proposals, Split Rock International, Inc., July 2010

[4] Internal Revenue Code, Section 199 (a)(1)

natural gas companies are limited, under the provisions of the Emergency Economic Stabilization Act of 2008, to a deduction of only 6 percent.[5]

Section 199 was added to tax law by The American Jobs Creation Act of 2004[6] in order to stimulate job growth in the production/manufacturing sector. After its enactment, oil and natural gas industry employment grew substantially, as intended, as our industry put the provision to work and created jobs. During the period after 2007, as the U.S. struggled through the financial crisis, our industry maintained steady employment figures, rather than shedding jobs. Again, as applied to our industry, the provision worked, helping maintain robust employment. It would be an unfortunate mistake for Congress to eliminate our use of Section 199.

Deduction for Intangible Drilling and Development Costs.
The deduction for intangible drilling and development costs, commonly referred to as IDCs, was included in the Internal Revenue Code in recognition of the fact that drilling oil and natural gas wells is a high-risk business, with uncertain chances of success. Even when drilling succeeds, the costs that comprise IDCs are largely "intangible," meaning they don't result in a physical asset. IDCs do not include the costs of "tangible," or physical production assets placed on the well site, once a commercially viable oil or natural gas well has been drilled. It is these facts that make the expensing of such costs appropriate, in precisely the same manner that a company that conducts extensive research and development (R&D) may deduct the costs of those efforts. As with R&D, the outcome or commercial success of those expenditures is far from certain when the costs are incurred. It is only after considerable cost and effort that a determination can be made on whether a drilling venture has discovered a commercially viable oil or natural gas well.

While the nature of the expenditure for IDCs is closely analogous to R&D, clearly the tax treatment afforded is far less generous, especially for integrated oil and natural gas producers such as ConocoPhillips. For them, the current deduction is already limited to 70 percent of the amount spent, with the remaining 30 percent capitalized and amortized over five years. Once again, as one examines the facts of this particular tax item, it becomes clear that, rather than being an oil and natural gas tax subsidy, the IDC deduction already provides a more limited cost recovery method than those enjoyed by other taxpayers and industries.

The impact of IDC repeal would be immediately felt throughout the oil and natural gas industry, costing thousands of jobs and harming domestic energy security. The ability to deduct IDC has a direct relationship to the number of wells drilled in the United States, and the number of jobs associated with that drilling activity. A typical evaluation regarding the decision whether to drill a well, or not to drill, will necessarily include an analysis of the costs (including tax costs) versus the possible cash flow, in the event the well is successful. If the net cash flow is evaluated and estimated to be positive on a present-value basis, that conclusion goes a long way toward an affirmative decision to drill a well. As the present value of the tax cost is increased by such factors as eliminating the current deduction of IDCs, the likelihood of a projected positive cash flow is diminished, thus increasing the likelihood that no well will be drilled. As more and more project evaluations are made, and applying the higher tax cost of non-deductible IDCs, more and more drilling projects will be abandoned. That will result in substantially less domestic drilling activity, and fewer American jobs associated with that activity.

This same type of analysis applies:

- Regardless of whether the company performing the analysis is a large integrated company, such as those attending this hearing today, or a small, independent producer;
- Regardless of whether the company doing the analysis has significant resources at its disposal, or must borrow against the potential success of each well, in order to fund the next;
- Regardless of how much a company has earned in its previous year, and because each drilling project must stand on its own in order to be successful, as the tax cost of that drilling project increases, the likelihood that the project will proceed decreases.

---

[5] P.L. 110-343, Division B, §401(a);
[6] P.L. 108-357

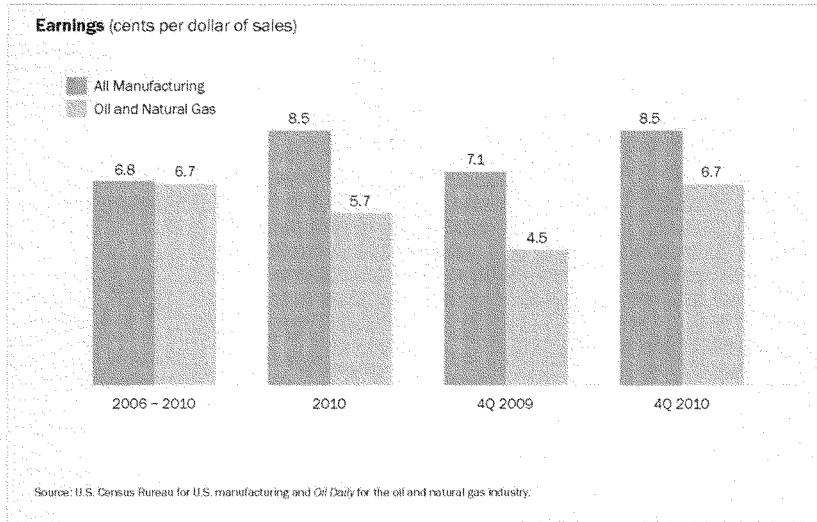
In short, this direct tax increase on U.S. drilling will reduce both drilling activity levels and energy production, and cost U.S. jobs.

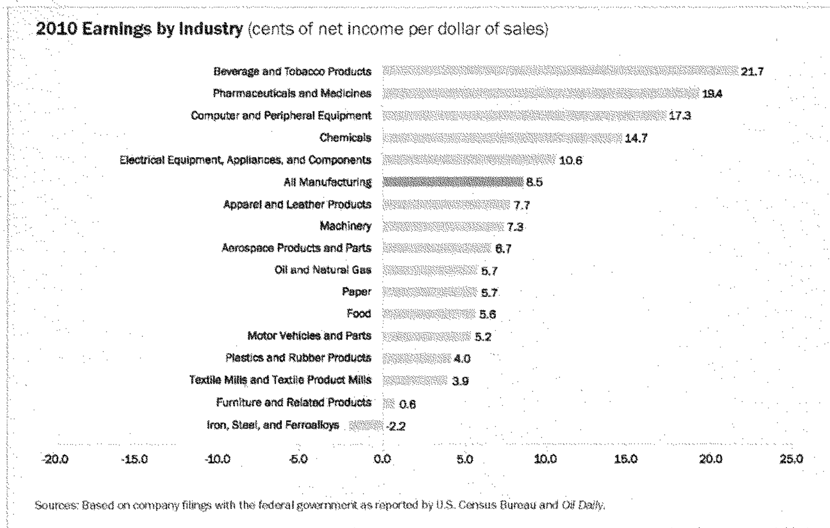
Other Provisions.
While there are numerous other tax provisions erroneously identified by industry opponents as "oil and natural gas tax subsidies," the provisions listed above are among the more egregious from the perspective of ConocoPhillips. In general, we oppose any effort to single out a specific industry, or a select few companies within a single industry, for tax increases. Such actions are simply bad tax policy – especially in cases in which the proposed increases all relate to measures utilized by a broad range of industries and taxpayers, and for which our company is already limited in its ability to utilize those tax attributes. Such actions are not "tax reform" or "elimination of tax subsidies." Instead, they come at the expense of the American workers who rely upon our industry for their livelihoods.

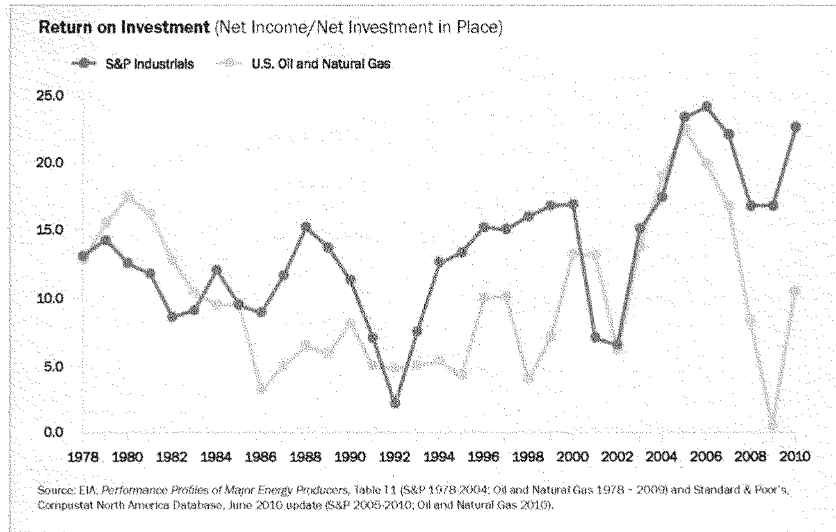
Industry Earnings and Profitability.
There is a common misperception that the absolute dollar amount of major oil company earnings is indicative of the industry's profitability. Rather, its earnings reflect the industry's enormous scale and the substantial capital investment needed to replenish depleting supplies. Constrained resource access at home and abroad has required international oil companies to undertake increasingly large, complex and risky projects that host governments may not have the financial strength, skills or technology to undertake themselves. A typical large ConocoPhillips exploration and development project requires several billion dollars of initial investment and may not generate revenues for more than a decade following project sanction. Deep water developments in the Gulf of Mexico can cost from \$6-\$16 billion, depending on the field size and other factors. A current project to produce and deliver liquefied natural gas may cost between \$5-\$13 billion, depending on its size, location and complexity. The proposed Alaska natural gas pipeline is expected to cost \$30-45 billion. Only large companies with substantial financial capacity and technical resources can effectively develop these projects, while sufficiently diversifying the number of projects and geographies to manage the risk. As the charts below illustrate, whether one examines earnings in the form of pennies per dollar of sales or return on investment, the U.S. oil and natural gas industry's earnings are comparable to those of other U.S. industries, or actually lag behind.

The first chart shows that earnings per dollar of sales for the oil and natural gas industry consistently lag the return on sales of all manufacturing industries for various periods from 2006 through 2010.

The second chart utilizes this same metric in comparing earnings on an industry basis during 2010. The earnings of the oil and natural gas industry lagged below the all-industry average (5.7 cents per dollar of sales for the industry vs. an average of 8.5 cents for all manufacturers). The leading industries (beverage and tobacco products, pharmaceuticals, computers, chemicals and others) had earnings far higher than those of the oil and natural gas industry.


Earnings (cents per dollar of sales)
All Manufacturing
Oil and Natural Gas
6.8
6.7
8.5
5.7
7.1
4.5
8.5
6.7
2006 – 2010
2010
4Q 2009
4Q 2010
Source: U.S. Census Bureau for U.S. manufacturing and Oil Daily for the oil and natural gas industry.


2010 Earnings by Industry (cents of net income per dollar of sales)
Beverage and Tobacco Products 21.7
Pharmaceuticals and Medicines 19.4
Computer and Peripheral Equipment 17.3
Chemicals 14.7
Electrical Equipment, Appliances, and Components 10.6
All Manufacturing 8.5
Apparel and Leather Products 7.7
Machinery 7.3
Aerospace Products and Parts 6.7
Oil and Natural Gas 5.7
Paper 5.7
Food 5.6
Motor Vehicles and Parts 5.2
Plastics and Rubber Products 4.0
Textile Mills and Textile Product Mills 3.9
Furniture and Related Products 0.6
Iron, Steel, and Ferroalloys -2.2
-20.0
-15.0
-10.0
-5.0
0.0
5.0
10.0
15.0
20.0
25.0
Sources: Based on company filings with the federal government as reported by U.S. Census Bureau and Oil Daily.



Conclusion – Raising Industry Taxes is the Wrong Policy at the Wrong Time

Once again, when the facts are made clear, proposals to use earnings to justify tax increases do not make sense in the case of an industry that is not only clearly already heavily taxed, but actually pays effective tax rates that far exceed those paid by other U.S. industries.

For a Congress and Administration that speak of the need to enhance U.S. competitiveness in global business, enacting the tax proposals currently under consideration would be counter-productive. They would penalize U.S. workers as well as the millions of Americans who invest in the targeted companies either directly as shareholders, or indirectly by participating in mutual funds, pension plans, insurance policies and other institutions that own our shares. Further, the proposed tax provisions would severely hamper the financial capabilities of the very companies that must help carry our nation into the energy future through continued investment in vital oil and natural gas, as well as in renewable energy resources.

These impacts cannot truly be the intent of Congress, or the desire of the American public.

ConocoPhillips calls upon Congress to dispassionately consider the facts on oil industry taxation, and reject the current proposals in light of the imperative need to create more U.S. jobs, enhance national energy security, and preserve and improve the ability of U.S.-flagged companies to succeed in the intensely competitive global energy business.

END

Senate Finance Committee Hearing
"Oil and Gas Tax Incentives and Rising Energy Prices"
May 19th, 2011
Questions for Mr. Jim Mulva

Note: All responses are current as of June 17, 2011.
From Senator Baucus

1. **Exxon Mobil has a recent posting by Ken Cohen, V.P. of Public and Government Affairs on its "policy blog" titled "ExxonMobil's U.S. taxes and U.S. earnings— Some relevant numbers for Washington. Mr. Cohen states that ExxonMobil had total tax expense of $9.8 billion in 2010 which exceeded total U.S. operating earnings of $7.5 billion. Footnote 18 of ExxonMobil's the 2010 Form 10-K filed with the SEC provides a breakdown of the total $9.8 billion. It includes $6.2 billion in "sales-based taxes".**

   I would like to ask each of you to describe the nature and amount of these U.S." sales based taxes" that you include as a tax expense in your financial statements. Are they federal excise taxes that are included in the price at the pump and effectively paid by consumers? Also, are these amounts included in your total sales reported on the income statement and therefore offset the amount reported as an expense?

   If these taxes are effectively passed on to consumers, isn't describing them generally as taxes paid by your companies similar to a retailer claiming that they pay the state and local sales taxes that they collect from consumers and remit to the appropriate governmental authorities.?

   Response:
   The amount of excise taxes paid on petroleum products sales is disclosed on the face of the income statement in ConocoPhillips' Form 10-K. These taxes have not been included in determining the company's effective tax rate.

2. **According to ExxonMobil's 10-K for 2010, for every 1 dollar increase in the price of oil, ExxonMobil earns a 375 million after-tax profit.**

   Last year, the average price of a barrel of oil was 72 dollars. The price of oil today is around 100 dollars and is projected to average over 100 dollars for the year.

   Doing simple math, if prices do average 100 dollars this year, ExxonMobil stands to earn in excess of 10 billion dollars in additional profit in 2011 than in 2010 just due to the increase in the price of oil.

In contrast, the total amount of tax breaks under consideration today is approximately 2 billion dollars for all the companies at the table combined.

I'd like to know from the other four companies how much in after-tax profit you earn from each 1 dollar increase in the price of oil.

Response:
A one dollar per barrel increase in the price of oil would add $110-130 million to our after-tax income in the short-term. However, it is important to note that companies do not capture all of the benefits of crude price increases. Much of the benefits of price increases are captured by governments via increased income, production and other taxes. This phenomenon can be observed by examining our oil and natural gas income statements for 2007 and 2008. Between 2007 and 2008, WTI crude prices increased from $72 per barrel to $100 per barrel or by 38 percent. ConocoPhillips' oil and natural gas revenues increased by about $14 billion but nearly two-thirds of those revenues went to pay for additional taxes ($8 billion) and cost ($1 billion) increases. This example also indicates that for every one dollar per barrel increase in the price of oil, tax payments to governments rise by almost $300 million.

In the medium to long-term, higher crude prices will increase costs in our business even more as industry capital spending increases and costs of materials and services rise in response to higher activity levels. This limits the degree to which higher crude prices improve profitability. In fact, industry finding, development and production costs have more than doubled since the early 2000s. And despite the elevated crude oil prices experienced during 2006 through 2010, U.S. oil and natural gas companies have had lower returns on investment than the S&P Industrials during this period.[1]

Wouldn't each of you agree that a price change of two or three dollars in a barrel of crude oil has a more meaningful impact on your investment decisions than your share of the effect of repealing all the tax provisions under consideration today?

Response:
No. Conservatively, it would require a $12.50 per barrel oil price increase sustained for 20 years to offset the proposed tax increases and maintain the same return for a large deep water Gulf of Mexico development project, for example. The crude oil price

---

[1] EIA, Performance Profiles of Major Energy Producers, Table T1 (S&P 1978-2004; Oil and Natural Gas 1978 – 2009) and Standard & Poor's, Compustat North America Database, June 2010 update (S&P 2005-2010; Oil and Natural Gas 2010)

increase needed would be even higher if you considered the cost inflation that would arise during a higher crude oil price environment.

The current crude oil price environment is less likely to influence our investment strategy than taxes. Given that crude oil prices are highly volatile and unpredictable, we analyze potential returns for proposed major projects over a wide range of possible price levels. Also, since crude oil prices are set globally they generally are not a factor when we determine the countries in which we will invest. Taxes, on the other hand, do help determine where we invest. Further, changes to tax laws are not subject to the same downward volatility that crude oil prices experience, since unlike crude oil prices, when taxes go up, they rarely come down. So, while we analyze projects under a variety of crude oil price scenarios, some of which assume significantly lower crude oil prices, any increased tax burden will be analyzed as a permanent cost increase for projects, regardless of crude oil prices.

Therefore, as noted above, tax terms are a very important determinant of where we invest. Projects will only be economic if the host country's tax terms are commensurate with the cost, prospectivity and risk of the upstream opportunities available. In order for projects in countries with higher costs and risks and lower prospectivity to remain economic, the government "take" through taxes must be lower. The U.S. is a high-cost area with lower prospectivity than many other areas in the world. Thus, projects here may not have economic potential that is sufficiently robust to accommodate higher taxes. This means that increasing U.S. taxes will likely render some projects here uneconomic. It will also drive companies to preferentially invest in foreign resource opportunities instead of domestic ones, which will reduce local job creation and increase oil imports.

Finally, higher taxes would lower the cash flow that enables the heavy levels of investment needed to maintain existing production and add new supplies.

Isn't the value of a price of oil the most important driver for your business planning?

Response:
Not necessarily. As previously mentioned, crude oil prices are highly volatile and unpredictable, such that we assess our plans over a wide range of potential prices. In addition, crude oil prices are set globally so they generally are not a factor when we determine the countries in which we will invest.

A wide range of other factors affect our decisions on what energy development projects to invest in, and where, including:

- Resource access
- Tax treatment and stability
- Local taxes
- Technology
- Drilling costs
- Geology
- Environmental regulations
- Geopolitics

Would you really consider producing less in the United States with the significant profits you earn with every additional barrel of oil produced?

Response:
If taxes were higher in the United States, we would likely invest less in this country, which would result in lower domestic oil and gas production. We would reduce our domestic investment for three reasons:

- Some of our proposed domestic and foreign projects would be made uneconomic by higher taxes,
- Some domestic opportunities would become less competitive than foreign projects, and
- The company would have less cash flow to invest in new projects and in maintaining existing production.

In fact, when Alaska raised its state tax rates in 2007, ConocoPhillips deferred $2 billion[2] of planned investment on projects that were no longer economically justified.

Projects Made Uneconomic
A study by the upstream economics consulting firm, Wood Mackenzie[3], assessed how many projects in the United States would be made uneconomic if proposed changes to intangible drilling cost (IDC) expensing and the domestic production activities deduction (Section 199) were enacted. The study indicated that returns for 88 projects – approximately 38 percent of the 230 plays in their domestic data base – would fall below the threshold required for investment.

[2] Gross investment
[3] Wood Mackenzie, "Evaluation of Proposed Tax Changes on the U.S. Oil and Gas Industry," August 2010

Wood Mackenzie also noted that in the current low natural gas price environment, some gas plays are sub-economic even before accounting for the proposed tax increases, and would become more severely disadvantaged under the additional tax burden.

Similarly, the loss of the Section 199 tax deduction would make domestic refining operations more vulnerable to foreign competition from Europe, and from new highly competitive world class refineries in Asia and the Middle East. Refined product imports are already highly entrenched in the U.S. market, during 2010 amounting to 2.6 million barrels per day or 14 percent of total oil demand.

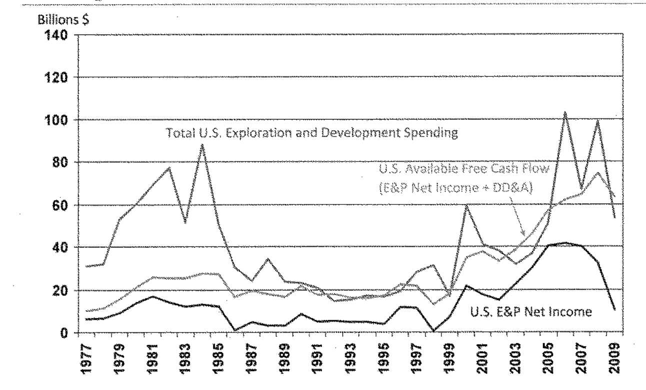
Domestic Projects Less Competitive than Foreign Projects

The U.S. is already less competitive than many other areas of the world due to its higher costs. U.S. finding and lifting costs were 35% higher than foreign finding and lifting costs, according to U.S. DOE Energy Information Administration (EIA) data from 2007 to 2009. Finding and lifting costs for the U.S. offshore were also 76% higher than average worldwide costs for major oil and gas producers in EIA's data base. Increasing taxes would further reduce the competitiveness of domestic investments.

Reduced Cash Flow

I also indicated that higher tax payments would reduce the amount of cash flow available for reinvestment in new projects and for maintaining existing production. Free cash flow from existing operations represents the primary source of funding for oil and gas investment. Oil and gas companies have historically reinvested 100% or more of their free cash flow (defined as net income after taxes, plus depletion, depreciation and amortization) into the development of current and future projects, as shown in the chart below based on EIA's Financial Reporting System data base of generally large integrated or large independent companies. If cash flow is reduced through higher taxes, there will be less money available to invest.

U.S. E&P Capital Spending vs. Earnings & Free Cash Flow



Source: EIA Financial Reporting System

Finally, I want to correct a common misperception that the absolute dollar amount of major oil company earnings is indicative of the industry's profitability. The large absolute size of major oil company earnings reflects our enormous scale and the size of capital investment needed to replenish depleting production and to enable growth. A typical large exploration and development project costs several billion dollars, and deep water developments in the Gulf of Mexico can cost from $6-$16 billion, depending on the field size and other factors. In fact, the oil and gas industry is no more profitable than other U.S. manufacturing industries. Between 2006 and 2010, the oil and gas industry earned 6.7 cents of net income per dollar of sales vs. 6.8 cents for all manufacturing industries.[4]

3. **Some of the witnesses have testified that the oil and gas industry is already subject to high effective income tax rates. They refer to overall effective rates in excess of 40 percent. But these rates appear to be a weighted average of both U.S. and non-U.S. income tax rates applied to domestic and foreign earnings.**

   From financial reports filed with the SEC, it appears the effective U.S. income tax rates are significantly lower than the average foreign rates. It seems that the high foreign rates are pushing up the total reported effective rate. One of the companies

[4] U.S. Census Bureau for U.S. manufacturing and Oil Daily for the oil and natural gas industry.

stated in their financial disclosure that the weighted average statutory tax rate in countries in which they operate was 55.3 percent for 2010.

I would like to ask each of you what the U.S. tax rate is on just your U.S. income. And how does that compare to foreign tax rates you pay on your non-U.S. income?

Response:
For 2010, the income tax rate on ConocoPhillips' U.S. income was 39%. For the first quarter of 2011 it was 41%. In addition to income taxes, our industry also pays severance and property taxes, royalties, and lease bonuses in the U.S. None of these additional items are "U.S. sales based taxes" as referred to in Senator Baucus' first question, but are in fact additional taxes borne by ConocoPhillips, none of which are included in the calculation of our effective tax rates.

The foreign income tax rate on foreign income for 2010 and the first quarter of 2011 were 44% and 51%, respectively.

So isn't the U.S. actually a favorable income tax environment in which to engage in production, refining and distribution?

Response:
Not necessarily. In addition to income taxes, our industry also pays severance and property taxes, royalties, and lease bonuses in the U.S. None of these additional items are "U.S. sales based taxes" as referred to in Senator Baucus' first question, but are in fact additional taxes borne by ConocoPhillips, none of which are included in the calculation of our effective tax rates.

In comparing the total U.S. government take to that of foreign governments, the form of payment matters. For example, lease bonuses are a higher share of the U.S. government's take in the Federal Outer Continental Shelf than in most other countries, according to petroleum tax consultant Daniel Johnston[5]. In present value terms, bonuses are about three times more costly to firms than royalties, because bonuses are paid up front rather than deferred until development yields production. Bonuses are also more risky than royalties, since they are often paid for acreage that is ultimately unproductive. Johnston has stated that government take in the U.S. OCS is actually on par with the rest of the world, if cost, present value discounting and risk are factored in.

[5] Daniel Johnston & Co., Inc., "Analysis of Government Take in the United States Outer Continental Shelf," January 10, 2008

Countries with higher government take on oil and gas production than the U.S. generally have lower costs and higher resource prospectivity, or their tax rates are out of line and as a result they aren't attracting sufficient investment.

The high cost structure of the U.S. constrains the amount of government take that domestic projects can bear and still remain economic. For example, U.S. finding and lifting costs were 35% higher than foreign finding and lifting costs between 2007 and 2009, according to U.S. DOE Energy Information Administration (EIA) data. Finding and lifting costs for the U.S. offshore were also 76% higher than average worldwide costs for major oil and natural gas producers in EIA's data base.

And wouldn't that still be the case, even if these subsidies did not exist?

Response:
No. In addition to my response to the previous question, increasing government take would directly hurt the economics of U.S. projects compared to those in other countries. The resulting instability of government take and the fact that the oil and natural gas industry would have been singled out in particular would also increase the perceived risk of investing in the U.S., which would increase the return threshold required for investment. Consequently, this would reduce investment in the U.S.

4. **Current tax rules arguably allow foreign tax credits for payments that are economically equivalent to royalties.**

   The proposal under consideration would limit creditable foreign taxes to generally applicable foreign taxes.

   The three largest US oil companies are on pace to earn 80 billion dollars in aggregate profit in 2011. Making the proposed changes to the foreign tax credit rules would cost your companies less than one percent of that profit.

   Is it a serious problem for your company to pay less than 1% of your profits for the proposed modification?

   Response:
   We strongly reject the assertion that the current foreign tax credit rules allow credits for payments that are economically equivalent to royalties. Such royalties are specifically excluded from being treated as income taxes. That very issue lies at the heart of the existing dual capacity taxpayer rules. The proposed changes to the foreign tax credits

would lead to double taxation of foreign earnings, which creates a competitive disadvantage for the three targeted U.S. oil companies, when compared to all other oil companies, domestic and foreign. It would have the effect of reducing U.S. jobs in our industry, since even foreign developments create the need for support functions located in the U.S., and would further increase the foreign ownership of worldwide crude oil supplies.

At this point, it is important to reiterate a concept that I described earlier. Regardless of our current earnings, we must evaluate new projects on the basis of what we expect the future to bring. As noted, we perform project analyses based upon a variety of price scenarios for crude oil and natural gas. As we all know, these prices can be highly volatile, which means that they can and do go down dramatically – as well as up. This proposed effort to impose double-taxation on our foreign earnings would be a permanent tax increase, which would remain in place regardless of the level of our future earnings.

Perhaps the most egregious aspect of this proposal, however, is that it clearly discriminates against U.S. companies. Only three of the five companies targeted by S940 would be significantly impacted – the three American-based companies. Non-U.S.-based companies will feel no real impact from the proposed double-taxation provision. This means that U.S. companies will be competitively disadvantaged in bidding against all other companies – whether they be investor-owned or government owned/controlled. As a result, the three largest U.S.-based companies will, over time, lose an increasing number of opportunities for investment in and production of crude oil and natural gas. This will not only have a discriminatory negative impact on these companies and their employees, but a recent study concluded that this provision alone will threaten a significant number of U.S. jobs and will further undermine our national energy security.[6]

5. **You testified before the Energy and Natural Resources Committee regarding energy prices and profits in 2005. During that hearing, you were asked whether President George Bush was right that with $55 per barrel oil, government incentives for gas and oil exploration and production were not necessary. And in 2005, you said that President Bush was right, that you did not need incentives and that these tax breaks did little to support and enhance supply.**

   Now, you have made recent public statements that eliminating these tax increases would "cost jobs, raise consumer prices, and … would hamper your ability to remain competitive." With the price of oil twice as high as it was when you testified in 2005, why do you now believe you need tax incentives?

[6] Olson, Pamela F., Jenn, Brian H. and Aldonas, Grant D., *Economic and Foreign Policy Implications of the Administration's "Dual Capacity Taxpayer Proposals"*, July 2010.

Response:
In the 2005 hearing, we were discussing the new production incentives in the Energy Policy Act of 2005. Most were for renewable energy, clean coal and nuclear. We do not need new incentives for exploration and production.

We do expect to deduct our operating expenses and recover our capital cost just like other companies in our industry, and those in every other industry. We also do not expect to have tax terms retroactively changed after we have made investments on the basis of existing tax law.

Foreign tax credits are not "tax breaks." They simply eliminate double taxation, and have been a fundamental part of U.S. tax code almost since the inception of the income tax itself. The proposed further restrictions on foreign tax credits would discriminatorily hamper the ability to compete of three American oil companies only. If the double-taxation proposal is enacted, these companies will be less able to bid competitively when vying for new projects against their foreign competitors, regardless of the crude oil price level.

Repealing the Section 199 domestic manufacturing deduction for the five largest oil and natural gas companies operating within the United States would deny us the benefit of a tax deduction that is available to every other industry and other large oil companies; some of which are foreign-owned. This deduction was enacted by Congress to increase domestic production and jobs in October 2004. Since then, domestic oil and natural gas production has increased by 15 percent and direct employment in the oil and natural gas extraction industry has increased by 36 percent[7]. Domestic production and job creation would be lower without it because (1) some projects would become uneconomic, (2) domestic projects might become less attractive than foreign projects and (3) companies would have less cash flow to reinvest.

We disagree with the implication of your question that with higher prices today, we should we able to absorb higher taxes. While the WTI oil price is near $100 per barrel today, crude prices are extremely volatile and we can't plan on them remaining at this or any other level. A case in point is that as recently as the start of 2009, the crude oil price was about $40 per barrel. For further explanation, please refer to my earlier response to Senator Baucus' question number 2.

[7] U.S. Bureau of Labor Statistics

The crude oil price level is not indicative of industry profitability over the long run because it doesn't address the rising costs faced by our industry. While elevated crude oil prices may temporarily improve our profitability, over time industry costs increase in response to rising crude oil prices, such that most of the benefit to earnings and returns are removed. This phenomenon prompted Goldman Sachs' energy analyst to project in 2008 that integrated oil companies were on track to generate a return on capital employed (ROCE) in 2010 at their $110 per barrel WTI price forecast that was comparable to their ROCE generated in 2000 at $30 per barrel.[8]

Oil and gas industry costs follow crude oil prices because the industry invests more capital when prices rise, and the cost of materials and services increases due to rising industry activity levels. The chart below illustrates the relationship between crude oil prices and a cost index for oil and gas machinery in the United States, which is one indicator of industry costs.

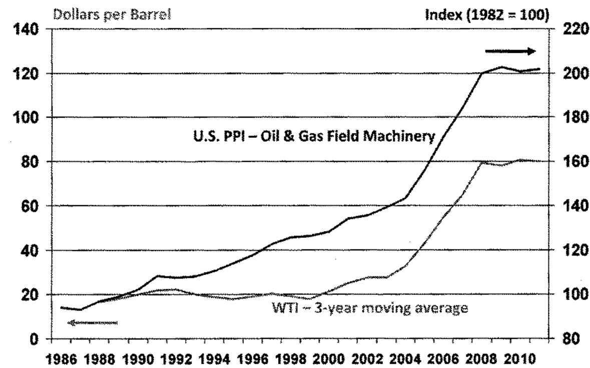
Another reason why the industry's cost structure rises with crude oil prices is that both costs and crude oil prices are driven upward during times of high economic growth in developing nations. Strong economic growth raises oil demand and prices as well as increases the cost of steel and other materials used by the oil and natural gas industry.

Other reasons for the rising industry cost structure are not directly related to crude oil prices. Industry finding and development costs are increasing because of the higher cost of the opportunities that are accessible by our industry today. Available prospects are more remotely located, in deeper water and harsher operating conditions that require new technology, or they contain unconventional resources that require significant upgrading. Given the higher cost and risk of the opportunities available today, reinvestment economics are frequently challenged despite relatively high crude oil prices. Limited resource access, including in the U.S., is exacerbating this problem.

---

[8] Arjun N. Murti, Goldman Sachs Global Investment Research, " Global: Energy: Oil," March 6, 2008, page 10

Oil & Gas Industry Costs Follow Crude Oil Prices

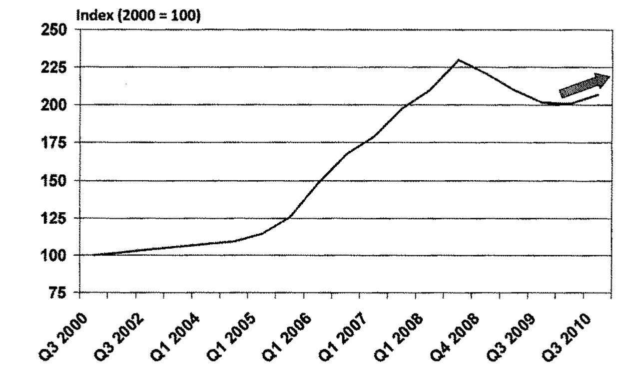


Source: U.S. Bureau of Labor Statistics and Platts

3

Since the early 2000s, industry finding, development and production costs more than doubled. At its peak in 2008, Goldman Sachs' analysts commented that the cost structure for the "marginal" supply (based on PPI Index for U.S. oil and gas field machinery and equipment) had reached $105 per barrel.[9] The chart below indicates that after a brief respite during the recession, industry capital costs (equipment, facilities, materials, and personnel) for construction of oil and natural gas projects are continuing to rise.

[9] The Goldman Sachs Group, "Energy Weekly," August 15, 2008, page 9



Several investment analysts have stated that marginal oil reserve replacement costs (to earn cost of capital and justify reinvestment) are about $85-90 per barrel today[10]. Thus, crude oil prices at least this high would be required in order to generate sufficient supplies to satisfy global oil demand. If crude prices remain above this level, then replacement costs will likely continue to rise. Again, the main point is that investment economics are challenging even when crude oil prices are higher than we have seen historically.

From Senator Baucus on Behalf of Senator Reid

1. **How much did your company spend in 2010 in the US on the research, development, demonstration or domestic production of clean, non-petroleum-based alternative transportation fuels?**

   Response:
   For 2010, ConocoPhillips spent approximately $34 million on R&D related to non-petroleum-based alternative fuels.

[10] Neil Beveridge and Liang Zhang, Bernstein Research, "Is this 2008 All Over Again?, April 15, 2011; Doug Terreson, ISI, "Energy Research: Integrated Oil," May 18, 2011

Please also identify the amount by which that estimated expenditure was effectively reduced through Federal tax deductions or tax credits, such as the research and development tax credit, claimed by the company.

Response:
For 2010, ConocoPhillips received an R&D tax credit related to non-petroleum-based alternative fuels of less than $1 million.

From Senator Wyden

1. **When arguing for opening up US lands and waters for oil drilling, the oil industry complains that because most oil is controlled by foreign governments, the US oil industry has no place else to go for access to oil and gas resources except in the US. But at today's hearing, you testified that if you lost the tax breaks you currently receive, more oil exploration and production would go offshore.**

   How can you claim both that you have no place else to go to drill for oil outside the US and that if you lose tax breaks you'll move operations offshore? Isn't that a contradiction?

   Response:
   To say that we have "no place else to go" mischaracterizes previous comments. Certainly, the competition for access to resources is increasingly challenging, not only in the U.S., but also globally. As described in my responses, the issue is not one of being completely denied access, or completely losing out in the competition, but one of relative access and success, compared to our competitors, in an increasingly difficult environment. The greater the burdens placed upon those U.S. companies with operations outside the U.S., compared to their peers, the more likely that they will lose out in the competition for new opportunities. Eliminating the Section 199 deduction for major oil and gas producers and requiring them to capitalize rather than expense intangible drilling costs would make a number of high-cost domestic opportunities uneconomic. This would make investment in U.S. projects less competitive relative to projects in other countries, and would incentivize our industry to move investment overseas; even perhaps to locations which are currently less economic under existing conditions, but would become more attractive after the proposed changes were enacted.

   As noted above, there are still foreign opportunities available, but they are generally either high cost or there is a great deal of competition to capture them. Imposing double-taxation by further restricting foreign tax credits would impede the ability of U.S. companies to compete for those opportunities. Again, it might not mean a complete "exit" from foreign opportunities, but it would certainly create a discriminatory

environment against U.S. firms competing with foreign companies which would not face the double-tax burden. These obstacles could very well, over time, significantly curtail or eliminate our non-U.S. presence, since the foreign assets we currently hold and the new projects for which we might otherwise compete will simply be more valuable to non-U.S. companies with lower tax burdens.

Again, I emphasize that it is a matter of relative economics, not a question of whether one location or another is completely economic or uneconomic. In short, my view is that the dual capacity taxpayer changes would make U.S. companies less able to compete in the global marketplace, and the other proposed tax changes would make the U.S. as a whole less able to compete for our industry's investment dollars.

In sum, if American companies are rendered uncompetitive both in the U.S. and overseas, they will be forced to reduce reinvestment rates in both. That's akin to slowly going out of business. While such a scenario might mean slightly less overall investment in energy, both globally and in the U.S., due to a somewhat smaller total industry investment, it does not mean that the proportion of the energy market currently held by U.S. firms would simply disappear. It simply means that the portion of the market currently held by U.S. companies providing U.S. jobs would then pass to foreign hands. It is in this country's interest from the objectives of energy security, economic prosperity and job creation to maintain a competitive U.S. oil and gas industry.

2. **During this morning's hearing, Mr. McKay responded that he agreed that it was appropriate to phase out the ethanol blending credit in light of the statutorily-mandated renewable standard requirement. Do you agree with Mr. McKay that it is time to phase out the ethanol blending credit?**

Response:
The blending credit for conventional ethanol is not needed given that ethanol usage in the fuel mix is mandated by federal law. However, during periods when there isn't an economic incentive to blend ethanol into gasoline, as when oil prices are low or corn prices are high, blending credits help mitigate the cost impact to consumers of the mandated ethanol, which is more expensive than gasoline.

Other mandated biofuels (cellulosic, biomass-based diesel, and advanced biofuel) are not generally expected to be economic in the foreseeable future. Absent modification, these mandates will impose additional costs on consumers.

From Senator Thune

1. **I want to discuss a particularly promising area of our country for domestic energy production, the Williston Basin located under parts of North Dakota, South Dakota, Montana and Canada. Some have called this area "Kuwait on the Prairie" because it holds the largest oil and gas find in North America since the Prudhoe Bay discovery in Alaska in the 1960s. Can you comment on the potential for job creation and economic development in the states I mentioned related to these oil and gas reserves. Would the tax increases in the President's budget and the legislation sponsored by Senator Menendez make you more or less likely to increase domestic production from these reserves, were these tax increases to be enacted into law?**

Response:

Oil production from the Bakken formation of the Williston Basin alone is expected to rise from about 60,000 barrels per day in 2005 to 600,000 barrels per day in 2014, making this area a bright spot for oil production growth in the U.S. Oil and gas drilling activity has increased significantly in the region. For example, the number of drilling rigs running in North Dakota has increased from a low of 35 in 2009 to 173 in 2011.[11] In addition to a direct gain in employment from this activity, jobs are created in other industries that provide goods and services to the oil and gas industry, and from household spending of personal income earned directly or indirectly from the industry's spending. According to the North Dakota Petroleum Council, each rig creates 120 direct and indirect jobs. The higher rig count in North Dakota over the last two years has thus theoretically created 17,000 direct and indirect jobs (173 – 35 = 138 x 120).

Although I am unaware of any economic development studies that focus specifically on this region, we can observe that it fared much better than the rest of the country during the recent recession. From January 2008 to April 2011, employment in North Dakota and South Dakota increased by 4.2 percent and 1.3 percent, respectively, while total U.S. private employment declined by 4.5 percent.

Raising taxes on the U.S. oil and natural gas industry will reduce our investment in new oil and gas supplies because some domestic projects would become uneconomic and we would have less cash flow to invest. It would also cause us to shift investment overseas. Reduced investment in the U.S. would reduce oil and gas production, as well as economic activity, employment, and government revenues. A study conducted last year by Louisiana State University[12] found that repealing the Section 199 and dual capacity

[11] North Dakota Drilling and Production Statistics: https://www.dmr.nd.gov/oilgas/stats/statisticsvw.asp

[12] Dr. Joseph R. Mason, PhD, Louisiana State University, "The Regional and National Economic Impact of Repealing the Section 199 Tax Deduction and Dual Capacity Tax Credit for Oil and Gas Producers," September, 2010

tax credits would reduce U.S. economic activity by $341 billion between 2011 and 2020, reduce employment by 154,000 immediately with the effects persisting for the duration of the tax policy, and reduce government tax revenues by $84 billion. A large proportion (59 percent) of the job losses would occur in professional fields (e.g., health care, real estate, etc.) and manufacturing. Only about one fourth of the losses would be in mining manufacturing, which includes oil and gas production and refining.

From Senator Rockefeller

1. **What was the average annual compensation for your company's top 5 executives over the past decade? Last year?**

Response:
ConocoPhillips' executive compensation program aligns the interests of our executives with those of our stockholders. Our compensation program is guided by the philosophy that the company's ability to responsibly deliver energy and to provide sustainable value is driven by superior individual performance. A company must offer competitive compensation to attract and retain experienced, talented and motivated employees. In addition, employees in leadership roles within the organization are motivated to perform at their highest levels by making performance-based pay a significant portion of their compensation.

The average annual compensation for our top executive officers since 2002, as disclosed in our filings with the SEC and calculated in accordance with the rules promulgated by the SEC and in effect when such filings were made, was $10 million. In 2010, the average annual compensation of our top executive officers was $8.7 million. Additional information about various elements of executive compensation packages is available in ConocoPhillips' Proxy Statements filed with the SEC.

What is the single most important tax incentive your business receives? Why?

Response:
Tax incentives are provided by Congress to encourage certain kinds of activities. Elimination of any tax incentives effectively increases taxation of those activities. This, in turn, results in a reduction in those activities, including oil and gas development and its related job creation.

2. **Two of your highest dollar tax incentives are Dual Capacity and Intangible Drilling Costs. Which of these two provisions is more important to your company and which you would choose to live without if Congress is forced to choose between the two?**

Response:
The foreign tax credit is not an incentive; it is the intended mechanism to eliminate double taxation of foreign earnings. Current tax rules already contain restrictions which do not allow royalties to be taken as a foreign tax credit. The proposed changes would arbitrarily disallow creditable foreign income taxes as foreign tax credits, resulting in double taxation, and is nothing more than a device to raise taxes on the three largest US oil companies.

3. **Some of you talk in your testimony of discriminatory treatment for your industry. It is my belief your industry has received preferred treatment for a century. Depletion goes back to 1916, and your industry was not eligible for the manufacturing subsidies that the section 199 subsidy replaced. Yet your companies' lobbying efforts allowed you to benefit from 199 when enacted. How do you reconcile such special treatment with claims of discrimination?**

Response:
ConocoPhillips is already ineligible for percentage depletion on oil and gas production (see IRC Section 613A), and has been so since 1975. Our industry remains eligible, like all other U.S. industries, for the Section 199 deduction, which was enacted to encourage domestic job creation in the manufacturing sector, which currently includes oil and gas production and refinery operations. However, our industry has already been discriminatorily penalized compared to all other manufacturing industries through the restriction of our Section 199 deduction to 6% versus the 9% otherwise allowed. Section 199 did not replace a "manufacturing subsidy." Section 199 was enacted in the aftermath of the World Trade Organization's invalidation of the so-called "FSC/ETI" regime, as an export subsidy. The Section 199 deduction was put in place to encourage job growth in the manufacturing and production industries, rather than as an export subsidy. For that reason, the Section 199 deduction is currently available to a wide variety of industries and taxpayers which did not benefit from the FSC/ETI regime.

From Senator Roberts

1. **Understanding that the five companies appearing before us today are all publicly traded, and are about 98% owned by individuals or institutional investors who are managing pension funds, mutual funds and IRAs for millions of middle class Americans that rely on these holdings for their economic security and retirement; what impact do your companies' record profits this past year have on middle class Americans whose economic portfolios invest in U.S. integrated oil companies?**

Response:
According to the economic advisory firm, Sonecon, the distribution of ownership of U.S. oil and natural gas company stocks is as follows:

- 29.5 percent by mutual funds and other firms
- 27 percent by pension funds
- 23 percent by individual investors
- 14 percent by IRAs
- 5 percent by other institutional investors
- 1.5 percent by corporate management of oil companies

We agree that many U.S. households benefit from the shareholder returns generated by oil and gas companies, given that 55 million households own mutual funds and 45 million have an IRA or personal retirement account.

A recent study by Sonecon commissioned by the American Petroleum Institute indicated that oil and natural gas company holdings in state pension funds are providing disproportionately strong returns for retirees. While oil and natural gas stocks make up an average of 3.9 percent of public pension holdings in four key states (Ohio, Michigan, Missouri and Pennsylvania), they accounted for an average of 8.6 percent of the returns in these accounts from 2005 to 2008.[13]

2. **How significant of a role does certainty in tax policy play for your companies when making investments decisions regarding greater domestic production and, more importantly, when hiring new employees?**

Response:
Certainty of tax policy is an important consideration in making investment and hiring decisions. Raising taxes would reduce investment in the U.S. because it would make some projects uneconomic, shift investment overseas and reduce cash flow available for reinvestment. Instability of government tax policy increases the risk of investing in the U.S., thereby raising the return threshold required of a project to offset the risk of higher taxes at some point in the future.

The U.S. already has some disadvantages in attracting oil industry investment. It has limited resource access, a higher cost structure and lower geologic prospectivity for oil in the areas that are open for exploration when compared to a number of other countries.

[13] Robert J. Shapiro and Nam D. Pham, Sonecon, "The Financial Contribution of Oil and Natural Gas Company Investments To Major Public Pension Plans in Four States, 2005-2009," April 2011, page 4

The U.S. government should recognize these disadvantages and do everything in its power to improve the attractiveness of investing in the U.S.

Historically, the U.S. has offered the advantage of stable fiscal terms that facilitated risk analysis and encouraged investment . The country is at risk of losing these attributes, which are vital to attracting energy investment.

Because higher taxes would reduce investment in new domestic projects, they would also provide a disincentive to hiring new employees.

From Senator Snowe

1. **With prices as high as $100 the question today is whether our energy tax policies are effectively creating incentives to change behavior – rather than simply making cost-effective business decisions only more profitable.**

   As a result, I find it interesting that in an analysis last year of the implications of removing these tax incentives that the American Petroleum Institute included an assumption that oil is at $80 per barrel. The analysis, done by Wood and Mackenzie, concluded that removing these tax incentives would alter the "breakeven" point for oil - that is the cost for profitability - from an average of $47.00 per barrel to $52.00 per barrel – or 10 percent.

   In addition, the report's executive summary concludes that under scenarios where oil is higher than $80 the removal of oil and gas subsidies would not affect oil production at all. While I recognize that additional subsidies lead to additional production, it would seem that there would be decreasing returns from more and more subsidies for US oil production.

   Specifically, while the report states concerns about the effects on natural gas production with the removal of subsidies the report states, "The impact to the oil =*[market is much lower, as less than 60,000 barrels are at risk under the proposed changes in 2011." Effectively, the report concludes that if oil is priced at points higher than $80 per barrel the removal of these incentives will not result in any lost oil production.

   At a time when oil is priced at roughly $100 – and if these prices were to continue – do you agree with the API report that there would not be any reduced production of oil in the United States if the tax incentives were removed?

Response:
I disagree with the conclusion that production in the U.S. would not be impacted at current oil prices if taxes were increased. First, I would like to clarify one point in your question. You referenced the "average" break-even cost for oil from API's Wood Mackenzie study (~$50 per barrel), but in fact it is the cost of the "marginal" or highest-cost supply that will determine how much production is lost. The Wood Mackenzie report indicated that the marginal cost of U.S. production was $80 per barrel. Now let me explain why applying this analysis to a higher crude oil price environment is likely to underestimate the adverse impact on oil production.

First, the Wood Mackenzie analysis likely understates the impact of tax changes on production when crude oil prices are $80 per barrel or lower. Their analysis did not include stripper wells (those that produce less than 10 barrels of oil per day). These represent over 85 percent of U.S. oil wells and yield 800,000 barrels per day, or 10 percent of U.S. Lower 48 crude oil production. Many of these wells are marginally economic, and higher taxes could cause some of them to be prematurely plugged and abandoned during the inevitable periods of lower crude oil prices. In addition, Wood Mackenzie's analysis excluded lease, exploration and appraisal costs for expensive new field development in the Gulf of Mexico and Alaska. Adding these missing costs raises the break-even price for investment in these areas. Thus, more production could be lost in a higher crude oil price environment than Wood Mackenzie suggested.

Further, we believe it is inappropriate to draw conclusions about production losses in a higher crude oil price environment than the study assessed. At a $100 per barrel oil price, the industry's global cost structure will be higher as a result of (1) an increase in capital spending outside the U.S. (spending would shift away from U.S. due to tax increases) that would bid up the cost of equipment and services, and (2) strong demand growth in the developing world (a major cause for higher crude oil prices) that would increase the cost of steel and other materials used by our industry. The response to Senator Baucus' question #5 provides greater detail on the relationship of crude oil prices and industry costs. The Wood Mackenzie study had a static cost structure by design so it is only appropriate to draw conclusions about lost production at the study's base price level.

Current crude oil prices are less likely to influence our investment strategy than taxes. Crude oil prices are highly volatile, fluctuating around an uncertain average. As a result, we can't plan on crude oil prices remaining at the current or any other level. A case in point is that as recently as the start of 2009, the crude price was about $40 per barrel. It can also take a decade for major projects to begin production, and we could be in a very different price environment then. As a result of extreme price uncertainty, we evaluate the viability of projects over a wide range of crude oil prices. Also, since crude oil prices

are set globally, they generally do not determine in which country we make investments. But taxes do.

Do you support removing these tax subsidies for oil at a certain point, perhaps the long-term level that EIA or your companies predict that oil will be in 5-10 years?

Response:
No. First, foreign tax credits should not be characterized as "subsidies." They simply eliminate double taxation. In addition, further restrictions on foreign tax credits would hamper the ability of the three American oil majors to compete globally at any crude oil price level. Please see my responses to previous questions from Senator Baucus – specifically questions 2, 3, 4 & 5.

Repealing the Section 199 domestic manufacturing deduction for the five largest oil and natural gas companies operating in the U.S. would deny us the benefit of a tax deduction that is available to every other manufacturer/producer and to other large oil companies. It would also incentivize a shift of investment, production and jobs outside of the U.S.

In recognition that no one can predict future crude oil prices accurately, our company evaluates new supply projects across a wide range of crude oil prices. Since we always consider a range of price outcomes when we evaluate investments, there is no price "threshold" that will make new investments immune from the impact of higher taxes.

As I previously indicated, costs tend to follow crude oil prices over time, which makes project returns less sensitive to oil prices than is commonly perceived. In fact, despite the elevated crude oil prices experienced during 2006 through 2010, U.S. oil and natural gas companies have had lower returns on investment than the S&P Industrials during this period.[14] Given that industry costs tend to catch up with crude oil price levels over time, there is no threshold crude oil price level where it would be "safe" to increase taxes without having a detrimental impact on U.S. investment, employment and production.

2. **We have witnessed the continued volatility of our energy futures markets, with for instance gasoline prices falling 7.6 percent on May 11th, 2011, coming during a year when gasoline has increased by more than 28 percent. The development yesterday came when the U.S. Department of Energy surprised traders by reporting an unexpected buildup of gasoline stockpiles in the previous week.**

[14] EIA, Performance Profiles of Major Energy Producers, Table T1 (S&P 1978-2004; Oil and Natural Gas 1978 – 2009) and Standard & Poor's, Compustat North America Database, June 2010 update (S&P 2005-2010; Oil and Natural Gas 2010)

This situation yesterday raises two critical questions regarding the efficiency of our energy markets. First, as the Commodity Futures Trading Commission is considering now, should we adopt position limits for particular traders to reduce the volatility of specific contracts. As a leader, along with Senators Feinstein and Cantwell, on developing a strong derivative title within the financial reform bill, I strongly believe transparency and restrictions on specific trades will not restrict price discovery, but will reduce volatility and potential for manipulation.

Secondly, trading on May 11th again demonstrates how critical it is for an efficient market to have access to accurate and timely data. This is not like any other market – information regarding consumption, production, and reserves are controlled, in some instances, by America's adversaries.

For instance, just last month the Wall Street Journal reported that "unreliable data on production, starting with the world's largest exporter, are adding to the price volatility..." and that the "revelation highlighted a problem that is roiling markets at the moment: a dearth of solid information about the true state of production and supplies."

As a result of these developments do you believe that the CFTC should adopt strict position limits for speculative traders and do you believe that there is enough transparency in these markets to accurately assess efficient pricing of oil?

Response:
As the question notes, energy prices vary with the global uncertainties surrounding supply and demand, including the effect of political and economic developments around the world and the vagaries of weather patterns. Energy markets are adapted to this, and function well, providing efficient pricing of oil and related products. It must be noted, however, that efficient markets are not markets that eliminate volatility. Instead, they effectively translate volatility in supply and demand expectations into prices, which in turn can be volatile. Position limits for speculative traders will not alter the fundamental uncertainties surrounding global supply and demand expectations. At the same time, position limits can be useful in limiting the potential for market disruptions during the period of contract expiration for futures contracts that provides for settlement by physical delivery. In establishing position limits, it is critical to assure, first, that there is an efficient process for managing exemptions for *bona fide* hedging activity, and second, that the limit is large enough that trading liquidity is not choked off, which could increase volatility.

Do you believe that current prices are reflective of supply and demand?

Response:
Yes. The primary cause of higher gasoline prices in the U.S. this year has been higher crude oil prices. Both retail gasoline prices and crude oil prices have increased by about 25 percent year-to-date 2011 versus 2010. The biggest component of retail gasoline prices at the pump is crude oil prices, representing over two-thirds of the pump price. Other contributing factors have been flooding in the Midwest that restricted gasoline-related shipping on the Mississippi River and unplanned refinery outages.

Current crude oil prices are being driven by strong developing country economic and oil demand growth, combined with disruptions to crude oil production in Libya and Yemen and fears in the marketplace about potential disruptions in other oil-producing nations. There is little ability in the marketplace to make up for any additional production disruptions, since there is only about 3-4 million barrels per day of spare OPEC production capacity currently available, which equals only about 5% of demand. This is considered to be a relatively tight market.

Do you believe that foreign countries are doing enough to supply the world with information about reserves and production and what can the United States government do to facilitate information sharing?

Response:
Data on OPEC oil production is generally reliable because there are several sources for the information, at least one of which estimates data from actual oil tanker sailings. In fact, there appears to be better real-time data on production in OPEC nations than in many non-OPEC nations. There is less agreement between sources on OPEC nations' oil production capacity.

We believe a bigger issue than the quality of production data is the poor quality and lack of timeliness of oil consumption data, particularly from developing countries. Perhaps the biggest recent surprises in the marketplace have been caused by the inability of analysts to accurately forecast demand over the coming year. For example, at the start of 2010, the International Energy Agency (IEA) projected that 2010 global oil demand would grow by 1.4 millions of barrels per day. The IEA now estimates growth at 2.8 million barrels per day, double the original estimate. The tightening market at year end surprised some analysts. Contributing to the poor ability to forecast demand is the inability to accurately forecast economic growth, which is the biggest driver of oil demand growth.

We believe the U.S. should continue supporting the IEA's participation in the Joint Organizations Data Initiative to improve the quality and timeliness of oil supply and demand data. This effort originated from the Producer-Consumer Dialogue. More than 90 countries participate now, including all of the major oil producers and China and India.

3. **The Tax Reform Act of 1986 is constantly referred to as a model for tax reform and the point often made any new reform we undertake should follow its lead, which was to broaden the base and to reduce tax rates. The phrase "broaden the base" is just a clever way of saying "eliminate tax provisions" such as credits and deductions that clutter the code in order to simplify the code and to provide the revenue needed to offset the corresponding reduction in tax rates.**

   The Democrats have presented us with an opportunity to broaden the base by eliminating certain tax provisions, namely, the tax benefits that are available currently to the five companies before us today. But instead of lowering the rates, the plan is to use the revenue from these cuts to pay down the deficit – just another way avoiding the spending cuts that the American people recognize has led us to these deficits.

   The Finance Committee has held a series of tax reform hearings and I thank Chairman Baucus for that. One thing we have learned is that the tax code is filled with too many special provisions and today we are debating yet one more complication to a tax code that is screaming for simplification.

   What we should be pursuing is a comprehensive energy plan at the same time we pursue comprehensive tax reform. There is wide agreement that the rates are too high for our American companies to remain competitive – even the Obama Administration has suggested cutting corporate tax rates. We could start to do so today, with a down-payment made on such rate reductions by the elimination of the oil and gas provisions currently on the table.

   We have to ensure the competitiveness of American companies and cutting the tax rate is one goal where we already have some consensus. We just need to agree on how to get there. Do you agree that reducing tax rates would justify the elimination of the oil and gas tax provisions we are discussing today? Do you think that rather than stop with these oil and gas provisions, we should also eliminate other energy subsidies in order to provide the broadest possible rate reductions?

Response:
We believe overall corporate tax reform that promotes investment in the United States and improves the international competitiveness of domestic companies is desirable. Any broad corporate tax reform should include lower rates and eliminate the U.S. taxation of foreign earnings (since they have already been heavily taxed in host nations). We also believe that stable non-discriminatory tax rules should provide equitable treatment for all companies, including those in the energy industry.

From Senator Enzi

You all indicated that you were in favor of overall corporate tax reform. In that regard, I have three questions:

1. **If Congress were to take up corporate income tax reform and eliminate provisions of the tax code that benefit traditional and alternative energy industries, to what rate would the corporate income tax need to be lowered to avoid a net tax increase on your company?**

   Response:
   Before we can answer this question, we would need to know precisely which provisions would be eliminated and/or how they would be modified to determine the breakeven tax rate. For example, the proposed dual capacity taxpayer provisions would be a significant blow to U.S. companies, but not to foreign-owned companies. This discriminatory, un-level playing field would have an impact well beyond the associated marginal increase in government tax revenue. That impact cannot be offset by any realistic change in the tax rate. If U.S. companies are double-taxed while their foreign competitors are not, they would be less competitive in many cases, without regard to the marginal tax rate.

2. **While I support the ideas of individual and corporate tax reform, I am concerned that a dramatic change in our tax code will be problematic for companies and individuals who have done long term tax planning. Do you agree with my assessment that there needs to be a phase in period? If so, how long should that phase in period be? If not, please explain how your company would handle such a change in the tax code.**

   Response:
   We would agree that dramatic changes in the tax code should be phased in. A phase-in period of five or more years could be workable, depending on the change.

3. **Are there any provisions of the tax code that you would prefer not be changed if we were to lower the corporate tax rate as a part of overall corporate tax reform?**

   Response:
   Any provision that would seek to increase U.S. taxation of our industry's foreign earnings would disadvantage domestic oil and natural gas companies, compared to our foreign competitors. Such a change would result in lost jobs here in the U.S. and would lead to increased foreign control of global oil supplies.

From Senator Cantwell

1. **The discussion of tax subsidies and incentives in the May 12, 2011 Finance Committee hearing was largely an abstract one on the overall economic and societal costs and benefits that result from these measures. I would appreciate having more specific information on the extent to which your firms have benefited from the tax provisions being discussed over the last decade. For your respective firms, would you please provide auditable data on your company's utilization of each of the following categories and for each of the past ten years (2000-2010):**

   - **Enhanced Oil Recovery Credit**
   - **Credit for Oil and Gas from Marginal Wells**
   - **Expensing of Intangible Drilling Costs**
   - **Deduction for Tertiary Injectants**
   - **Passive Loss Exception for Working Interests in Oil Properties**
   - **Percentage Depletion for Oil and Natural Gas Wells**
   - **Domestic Manufacturing Deduction for Oil and Natural Gas Companies**
   - **Geological and Geophysical Amortization**
   - **Net annual profit**

   Response:
   Please see attached spreadsheet, showing the amounts for each item, for each year requested.

   I think we can all agree that America's future prosperity and competitiveness is contingent on figuring out how we can live within our means while providing our businesses more predictability and stability in the marketplace, in part by providing a more level playing field for all market participants. I would argue that one thing we can do is to ensure that U.S. industries all receive equal treatment under the federal tax code so that they operate on an equal footing. I don't understand, for example, why oil companies should be allowed to write off the costs of machinery and other so-called "intangible costs" immediately, while companies in other

industries have to write off these expenses gradually, over the lifetime of the equipment they purchase. Likewise, a few years ago, Congress to redefine the word "manufacturing" so that oil companies could take advantage of a manufacturing tax deduction for oil production.
I was intrigued by an argument that Mr. Watson made in his testimony, which if I understood him correctly, argued that we should not change tax breaks for the oil industry outside of a broader context of corporate tax reform.

Does that mean that you might all be willing to work with Congress to figure out ways to simplify and reform our nation's byzantine tax code in the interest of replacing the myriad of tax expenditures we are discussing here today with lower overall corporate tax rates for all industries?

Response:
We would be willing to work with Congress to simplify and reform the U.S. tax code and create a system that promotes investment here at home while improving the ability of U.S. companies to compete internationally. Any broad corporate tax reform should include lower rates, and eliminate or avoid the U.S. taxation of foreign earnings, since they are already heavily taxed by the host nations. We also believe that stable non-discriminatory tax rules should provide equitable treatment for all companies, including those in the energy industry.

2. **Considering all the uncertainties that affect your industry and the United States as a whole, would you support efforts to create a policy framework which provides greater certainty and stability when it comes to energy prices, regulation, and supply and demand fundamentals? I believe that is an important question because eventually Congress will regulate greenhouse gas emissions. This moment may come as soon as next year if the DC Circuit throws out EPA's tailoring rule. Would your companies support be supportive of legislation that established a price on carbon in a manner that was transparent, market-based, technology and fuel neutral, and economy-wide, as an alternative to EPA regulation of greenhouse gases?**

   Response:
   ConocoPhillips advocates the development of effective and efficient national policy that addresses greenhouse gas emissions and the impacts of climate change, while ensuring availability of a secure supply of the affordable energy necessary for economic growth. We remain opposed to what we believe are less efficient, costlier and less environmentally effective policy approaches. These include using existing environmental

statutes (e.g. the Clean Air Act) in an attempt to regulate greenhouse gas emissions, or developing a patchwork of state programs and technology mandates that impose targets that must be met at any cost. We believe that over the months and years ahead, as governments – federal, state and local – act upon the issue of global climate change, ConocoPhillips and other energy companies must continue playing a constructive role in the public policy dialogue.

3. **Both the Joint Economic Committee and the Congressional Research Service produced analyses that show that removing tax expenditures to the oil industry as proposed in S. 940 will not lead to significant gasoline price increases or oil production decreases. To you agree with conclusions of these reports? And if not, please describe in detail the flaw or flaws in their analyses. Are there any independent studies that demonstrate that eliminating these tax expenditures will significantly increase prices or reduce domestic oil and gas production?**

Response:
The referenced reports by the U.S. Congress Joint Economic Committee (JEC)[15] and Congressional Research Service (CRS)[16] had several flaws that led to conclusions that we believe are unwarranted. The paragraphs below contain our views of these flaws, along with references to other studies that disagree with the conclusions in these reports.

The JEC report stated that increasing taxes would have no impact on oil and gas production because it would not impact marginal cost. First, it ignored the high marginal replacement cost of many new supplies in the U.S., which is a particularly high cost region in which to explore and operate. Disallowing the expensing of intangible drilling costs will have a particularly chilling impact on large, long-lead-time development projects in the deep water Gulf of Mexico and Alaska. Second, the report ignored the impact that lower cash flow from tax increases would have on revenues available for reinvestment. Third, it ignored the shift in investment from domestic to foreign production that would be driven by elimination of the Section 199 credit and the ability to expense intangible drilling costs. The report also did not address the adverse impact on domestic natural gas production, which is currently experiencing very low prices. A recent study by the energy consulting firm, Wood Mackenzie, analyzed the economic impact on 230 fields and drilling trends in the U.S. and found that eliminating the expensing of intangible drilling costs and the application of the Section 199 tax credit to the oil and natural gas industry would reduce oil and natural gas production by up to

[15] U.S. Joint Economic Committee, "End Tax Breaks for Big Oil: Reduce the Federal Deficit Without Increasing Prices At the Pump," May 2011
[16] Robert Pirog, Congressional Research Service, "Oil and Natural Gas Industry Tax Issues in the FY2012 Budget Proposal," March 3, 2011

600,000 barrels per day in 2011, with a loss of more than 10 percent of U.S. productive capacity by 2017.[17]

The JEC report states that these "tax breaks" have not led to lower gasoline prices for consumers. This conclusion is unwarranted given that we cannot know what gasoline prices would have been without these tax provisions if all other factors remained equal.

The JEC report indicates that eliminating these tax provisions would help reduce the federal deficit. However, actions that discourage investment in domestic oil and gas development are likely to result in lower domestic oil and natural gas production, reduced economic activity, lower employment in the oil and natural gas and complementary industries, and in turn lower government revenues. In fact, a report from Louisiana State University[18] indicated that repealing the Section 199 and dual capacity tax credits would decrease U.S. federal tax receipts by $65 billion from 2011 to 2020, with a loss in state and local tax receipts of $18 billion during this period. Looking solely at the revenue losses from lost oil and natural gas production, a 2009 study by the Energy Policy Research Foundation, Inc.[19] indicated that a production loss of 160,000 barrels per day or higher will result in the U.S. Treasury experiencing a larger financial loss than the expected gains from increased taxes.

Another concern with the JEC report is it's conclusion that oil and gas subsidies may impede investment in alternative energy sources. This conclusion also seems unwarranted given the various existing state and federal alternate energy mandates and production incentives. Several years ago a study by the U.S. Department of Energy EIA[20] concluded that subsidies for ethanol and biofuels in 2007 amounted to $5.72 per million BTUs, while oil and natural gas only received $0.03 per million BTUs. For electricity production, wind and solar received subsidies and support per unit of production of $23-24 per megawatt hour, versus equivalent subsidies to natural gas and petroleum liquids of $0.25 per megawatt hour.

The CRS study referenced in your question concluded that the tax increases on the oil and natural gas industry may have the effect of decreasing exploration, development and

---

[17] Wood Mackenzie, "Evaluation of Proposed Tax Changes on the U.S. Oil and Gas Industry," August 2010, page 10

[18] Dr. Joseph R. Mason, PhD, Louisiana State University, "The Regional and National Economic Impact of Repealing the Section 199 Tax Deduction and Dual Capacity Tax Credit for Oil and Gas Producers," September, 2010, page 18

[19] Energy Policy Research Foundation, Inc., "Do Higher Oil and Gas Taxes Pose A Threat to U.S. Energy Security? An EPRINC Assessment of the Administration's Proposed Tax Policies Regarding the Domestic Petroleum Industry," August 4, 2009, page 12

[20] U.S. Department of Energy, EIA, "Federal Financial Interventions and Subsidies in Energy Markets 2007," April 2008, Table ES6, page xviii and Table ES5, page xvi

production, while increasing prices as well as the nation's foreign oil dependence (page 8). We agree with these points. However, the report went on to provide an alternative view that these tax preferences have favored the oil and natural gas industry over other energy sources (page 8). We have already shown above that alternative energy receives far greater tax preferences than oil and natural gas and has the additional benefit of various state and federal mandates of its use.

The CRS report also indicates that reductions in drilling budgets are likely to be determined by the price of oil (page 4). That may be true in the short run, but in the long run industry costs rise with the crude oil price as the industry increases capital spending and costs of services and equipment rise in response to higher activity levels. A higher crude oil price is also indicative of strong developing nation economic growth, which increases the cost of steel and other materials used by our industry. In addition, industry costs are rising over time due to the greater complexity and cost of opportunities available (e.g., those more remotely located, in deeper water and harsher operating conditions that require new technology, or that contain unconventional resources that require significant upgrading). As a result, "marginal" break-even prices are rising, and tax increases would cause production to be lost at higher crude oil prices than might otherwise be expected.

Another concern with the CRS report was the point alleging that repeal of the manufacturing tax deduction would not impact employment because the oil and natural gas industry is capital intensive (pages 5-6). However, since this deduction was enacted in the American Jobs Creation Act of 2004 (October 2004), domestic oil and gas production has increased by 15 percent and direct employment in the oil and natural gas extraction industry has increased by 36 percent.[21] Domestic production and job creation would be lower without the Section 199 credit because (1) some projects would become uneconomic, (2) domestic projects might become less attractive than foreign projects and (3) companies would have less cash flow to reinvest.

One final point about the CRS study is that it acknowledges that changing the dual capacity rules would reduce after-tax revenues and returns from overseas investments, which could lead to U.S. firms choosing to invest in fewer marginal overseas projects (page 8). While we agree with this point, we think it understates the impact. Further restricting the use of foreign tax credits would make the three largest U.S. oil and natural gas majors uncompetitive with foreign companies, including national oil companies and foreign oil majors, in both overseas and domestic investments, since the U.S. companies will not be able to afford to bid as much as foreign companies on opportunities at any crude oil price level.

[21] U.S. Bureau of Labor Statistics

ConocoPhillips and Subsidiaries
Senate Finance Committee Hearing
Oil and Gas Tax Incentives and Rising Energy Prices
May 12, 2011

Detailed Data Response to Question 1 from Senator Cantwell:
$ Millions

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
Enhanced Oil Recovery Credit [a]	32	54	42	39	47	64	0	0	0	0	0	278
Credit for Oil and Gas from Marginal Wells	0	0	0	0	0	0	0	0	0	0	0	0
Expensing of Intangible Drilling Costs	218	346	312	539	249	410	986	1,406	1,558	1,136	802	7,962
Deduction for Tertiary Injectants [b]	3	5	14	307	240	293	N/A	N/A	N/A	N/A	N/A	862
Passive Loss Exception for Working	0	0	0	0	0	0	0	0	0	0	0	0
Percentage Depletion for Oil and Natural Gas	0	0	0	0	0	0	0	0	0	0	0	0
Domestic Manufacturing Deduction	0	0	0	0	0	328	345	722	540	62	210	2,207
Geological and GeoPhysical Amortization	N/A	N/A	N/A	N/A	N/A	N/A	14	34	45	56	69	218
Net Annual Profit/(Loss) - Annual Report [c]	1,862	1,661	(295)	4,735	8,129	13,529	15,334	11,458	(16,349)	4,414	11,358	55,836

[a] Note, the Enhanced Oil Recovery Credit represents the dollar amount of the credit. All amounts shown for other items represent the deduction amount, not the net tax benefi

[b] Due to the phaseout of the enhanced oil recovery credit, ConocoPhillips no longer identifies specific deductions as being section 193 tertiary injectant expenses; therefore, this data was not available for periods after 2005.

[c] Periods prior to 2006 do not reflect a change in accounting principle adopted on January 1, 2010.

From Senator Menendez

1. **According to the Energy Information Administration, the average cost to produce a barrel of oil is around $33; but SEC filings show that the average production costs for the Big 5 are much lower, at about $11. With a barrel of oil selling for around $100, why do you need subsidies? Can each of you tell the Committee and the American people what price per barrel and profit margin you will need to reach before these subsidies are no longer necessary?**

Response:
First, financially reported finding, developing and production costs, such as the Energy Information Administration's (EIA) $33 per barrel, are not representative of full reserve replacement costs because they exclude a number of significant costs involved in developing new projects. Among these are income taxes, which are a large portion of industry costs; compensation for the time value of money, which can be considerable given the 10 or more years from initial investment to production for major projects; and financial returns on the project investment. The $11 per barrel of oil production cost referenced above from SEC filings appears to include only production cost, and does not include any capital costs. Thus, it is not determined on the same basis as either the EIA's numbers or full reserve replacement costs.

Another issue with financially reported numbers is that they represent "average" costs that are substantially lowered by inclusion of legacy assets that have produced for many years. New projects generally have much higher costs, some of which are attributable to restricted access to opportunities available to publicly traded oil companies. For example, the new prospects are more expensive to develop than the legacy assets because they are typically more remotely located, in deeper water and harsher operating conditions that require new technology, or they contain unconventional resources that require significant upgrading. As a result, break-even prices for new investments are thus much higher than a company's average costs.

When taxes are increased, we lose the "marginal" or highest cost barrel of production, and not the "average" cost barrel. Several investment analysts have stated that marginal oil reserve replacement costs (to earn cost of capital and justify reinvestment) are about $85-90 per barrel today.[22] Reserve replacement costs are continuing to rise above this level with higher crude oil prices as the oil and natural gas industry increases its capital

[22] Neil Beveridge and Liang Zhang, Bernstein Research, "Is this 2008 All Over Again?, April 15, 2011; Doug Terreson, ISI, "Energy Research: Integrated Oil," May 18, 2011

spending and the cost of services and equipment rises in response to higher activity levels. Additionally, strong developing country economic growth (associated with higher crude prices) causes cost increases in the steel and other materials we use. The relationship between reserve replacement costs and crude oil prices is more fully addressed in the response to Senator Baucus' question number five.

In response to your question about whether tax incentives are needed when oil prices are $100 per barrel, first foreign tax credits should not be characterized as "subsidies." They simply eliminate double taxation. In addition, further restrictions on foreign tax credits would hamper the ability of the three American oil majors to compete globally at any crude oil price level. Please also refer to my responses to Senator Baucus' questions above – specifically, questions 2, 3, 4 and 5.

Repealing the Section 199 domestic manufacturing deduction for the five largest oil and natural gas companies would deny us the benefit of a tax deduction that is available to every other industry and to other large oil companies. It would also incentivize a shift of investment, production and jobs to foreign locations.

Since no one can predict future crude oil prices accurately, our company evaluates new supply projects across a wide range of oil prices. Regardless of how high crude oil price levels are today, projections for expected returns from new projects would be influenced by the risk of low oil prices in the future. Similarly, in early 2009 when the crude oil price was about $40 per barrel, projections for expected returns of new projects would have been influenced by the risk of high oil prices in the future. Since prices are unpredictable and we always consider a range of price outcomes when we evaluate investments, there is no price "threshold" that will make new investments immune from the impact of higher taxes.

As I previously indicated, since costs tend to follow crude oil prices over time, project returns are less sensitive to crude oil price levels than is commonly perceived. In fact, despite the elevated crude oil prices experienced during 2006 through 2010, U.S. oil and natural gas companies have had lower returns on investment than the S&P Industrials during this period.[23] Thus, there is no threshold crude price level where it would be "safe" to increase taxes without having a detrimental impact on U.S. investment, employment and production.

[23] EIA, Performance Profiles of Major Energy Producers, Table T1 (S&P 1978-2004; Oil and Natural Gas 1978 – 2009) and Standard & Poor's, Compustat North America Database, June 2010 update (S&P 2005-2010; Oil and Natural Gas 2010)

A profit-margin threshold would address concerns about high costs in a high price environment, but you will quickly find that our industry is no more profitable than any other, even during periods of high crude prices. Between 2006 and 2010, the oil and gas industry earned 6.7 cents of net income per dollar of sales vs. 6.8 cents for all manufacturing industries.[24] There is a common misperception that the absolute dollar amount of major oil company earnings is indicative of the industry's profitability. The large absolute size of major oil company earnings reflect our enormous scale and the size of capital investment needed to replenish depleting production and enable growth. A typical large exploration and development project costs several billion dollars and deep water developments in the Gulf of Mexico can cost from $6-$16 billion, depending on the field size and other factors. ConocoPhillips alone plans to invest $13.5 billion dollars in 2011, which we could not afford if we did not have a similar level of earnings.

2. **Please provide a detailed accounting of how many dollars your company did not pay in taxes as a result of the tax subsidies proposed to be eliminated in S.940, the Close Big Oil Tax Loopholes Act, for each of the last 5 years.**

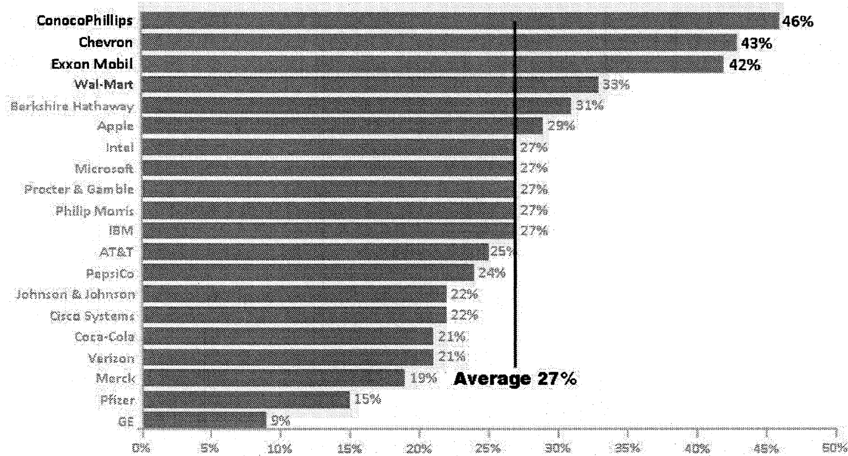
   Response:
   We disagree with the characterization of the proposals contained in S. 940 as elimination of subsidies. The foreign tax credit proposal leads to double taxation of foreign earnings and would be a discriminatory penalty, not elimination of a subsidy. Please see the response to Senator Cantwell's question number 1 for our tax return data.

3. **In your testimony before the Committee, you presented the chart I have included below which allegedly shows the effective income tax rates of many of the largest companies in the U.S., but the chart is highly misleading. It appears to significantly overestimate your tax contribution by including things like gas taxes which are paid by end-users, not your company. We also know from your Securities and Exchange Commission filings that your tax bill is much higher overseas than it is here in the U.S. Lastly, a pair of GAO reports reveal that U.S. royalty rates are among the lowest in the world. So, while your chart seems to indicate that oil companies are somehow mistreated, the truth is that the U.S. has some of the most favorable laws for oil companies in the world. Nonetheless, there is something about your chart and testimony that I think is quite interesting. You pointed to General Electric—at the very bottom of your chart—as a company that is barely taxed compared to ConocoPhillips. You are not alone, the New York Times recently published a piece explaining how GE earned $14.2 billion in profits, paid zero dollars in taxes, and**

[24] U.S. Census Bureau for U.S. manufacturing and Oil Daily for the oil and natural gas industry.

claimed a tax benefit of $3.2 billion in 2010. Mr. Mulva, by showing this example and comparing it to how oil companies are taxed, are you suggesting that GE should be paying more in taxes? If so, do your fellow members on the Board of Directors of GE, know you are counseling the Senate Finance Committee to close tax loopholes for companies like GE?

U.S. Energy Companies Are Already Heavily Taxed



2006-2010 Effective Income Tax Rates of Largest U.S. Non-Financial Companies

Response:

I stand behind the information contained in the chart. During its preparation, our staff relied upon publicly-available information from Bloomberg for the companies listed. I can assure you that for ConocoPhillips, the tax figures shown do not include "things like gas taxes which are paid by end-users." In fact, assuming that those "things like gas taxes," to which you refer include state and federal motor fuel taxes, state severance taxes, property, sales and other "non-income" taxes, you will find them all included in our financial statements as "Taxes other than income taxes." In fact, if you read the caption below the chart, you may note that it states, "2006-2010 Effective *Income* Tax Rates for the Largest U.S. Non-Financial Companies." [Italics mine.] In short, ConocoPhillips' effective income tax rate, as represented on the chart, is not "highly misleading," nor does it "significantly overestimate" our tax contribution.

Regarding your comment about income taxes paid outside the U.S., it is often, although not in all cases, true that the income taxes we pay on our foreign earnings are higher than the income taxes we pay on our domestic U.S. operations. It is also true that the majority of our earnings come from outside the U.S. When we examine the effective income tax rate applicable solely to our US operations, that rate is typically near or above the 35% U.S. statutory corporate income tax rate. This information clearly indicates that we pay

high rates of tax, compared to other companies and other industries, whether one looks at our global operations, or solely at our domestic operations.

In response to your comment that "the U.S. has some of the most favorable laws for oil companies in the world," I would like to point out that in comparing the U.S. government take to those of foreign governments, the form of take matters. For example, lease bonuses are a higher share of the U.S. government's take in the Federal Outer Continental Shelf than in most other countries, according to petroleum tax consultant Daniel Johnston. In present value terms, bonuses are about three times more costly to firms than royalties because they are paid up front, rather than deferred until development yields production. Bonuses are also more risky than royalties, since they are often paid for acreage that is ultimately unproductive. Johnston has stated that if cost, present-value discounting and risk are factored in, the government take in the U.S. OCS is on par with those in the rest of the world. Countries with higher government take on oil and gas production than the U.S. generally have lower costs and higher resource prospectivity, or their tax rates are out of line and they aren't attracting sufficient investment.

The high cost structure of the U.S. constrains the amount of government take that projects can bear and still remain economic. According to U.S. DOE Energy Information Administration (EIA) data, U.S. finding and lifting costs were 35% higher than foreign finding and lifting costs between 2007 and 2009. These costs for the U.S. offshore were also 76% higher than average worldwide costs for major oil and natural gas producers in EIA's data base. In short, the U.S. government take is, per Daniel Johnston, on par with the rest of the world, but other costs in the U.S. are significantly higher. As a result, the U.S. is quite often not among the most economically attractive places to invest.

Regarding your final comment/question related to the chart, the purpose of the chart was not only to illustrate that our company and our industry are already highly taxed, but also to highlight the disparities in tax treatment among industries and even among companies within the same industry. I believe that these facts clearly highlight the need for tax reform in this country. ConocoPhillips stands ready to engage and provide input to a responsible tax reform debate, one that seeks to establish tax equity among taxpayers and economic prosperity for our country, rather than attempting to vilify any industry or company for political gain.

4. **In a press release the day before your testimony before the Committee, your company called my legislation "un-American." In your testimony, you were unapologetic for questioning my patriotism, that of my cosponsors, President Obama, 52 Senators who voted for my legislation and the 74% of Americans who**

support efforts to cut wasteful oil subsidies. Why are you unwilling to retract such a ridiculous assertion?

Response:
The headline in ConocoPhillips' media release regarding the tax bill, itself, was taken out of context. The point was simply that this country was founded, in part, on the principle of fair taxation and targeting in a discriminatory manner a few select companies for tax increases and penalties does not abide by this principle. Further restricting foreign tax credits for U.S. oil companies is double taxation, which does not meet the standard of fair taxation. It would make those American oil companies uncompetitive with their foreign counterparts at any oil price level. The fact that this proposal would unfairly discriminate against American workers and employers – and only against American workers and employers – is, to us, the most egregious and alarming aspect of this legislation. We encourage the Committee to undertake broad corporate tax reform, but ask that it refrain from discriminating against specific industries and companies – especially American companies.

END

Questions for the Record

Senator Cornyn

Senate Committee on Finance: "Oil and Gas Tax Incentives and Rising Energy Prices"
Response from James J. Mulva, Chairman and Chief Executive Officer of ConocoPhillips
May 12, 2011

TAXING DOMESTIC PRODUCERS

1. Has there been any analysis done on how these domestic energy tax hikes would impact the 9.2 million jobs that the industry supports? Can you tell the Committee what it will mean to your operations?

   Response:
   A recent study produced by Professor Joseph R. Mason, PhD, stated that if the Section 199 deduction and the dual capacity taxpayer provisions were modified as proposed, the U.S. could experience a loss of over 154,000 jobs in the first year, and an average annual job loss in excess of 118,000 over the following ten-year period.[1] This study did not include the potential impacts from loss of the deduction for intangible drilling costs (IDC). A recent study conducted by Wood MacKenzie[2] estimated that the employment impact of all of the Administration's oil and gas tax repeal recommendations would be an annual loss of 170,000 jobs in 2014, and annual losses of 40,000 by 2020 and 28,000 by 2025.

   While we have not performed a detailed analysis of projected job losses related to ConocoPhillips' activities, if all the proposed tax changes were to be enacted, we certainly would be compelled to reduce capital spending, at the very least, for projects which would be rendered uneconomical under the heavier tax burden. A decrease in capital spending will translate into a decrease in projects which will result in fewer job opportunities, not only for our own employees, but also for the thousands of contractors which we use on a daily basis.

2. How does the U.S. tax policy influence company decisions to invest in the United States to develop new energy sources?

   Response:
   Tax policy can be a primary driver of investment decisions, since such policies can significantly alter the economics of a project, impacting the final decision to proceed with or abandon a planned project. In our initial evaluation of a potential project, we will first

[1] Mason, Joseph R, PhD, The Regional and National Economic Impact of Repealing the Section 199 Tax Deduction and Dual Capacity Tax Credit for Oil and Gas Producers, Louisiana State University, September 2010.

[2] Energy Policy at a Crossroads: An Assessment of the Impacts of Increased Access versus Higher Taxes on U.S. Oil and Natural Gas Production, Government Revenue, and Employment, January 4, 2011, June 24, 2011 Revision.

generally look at other indicators such as geological prospectivity, expected market conditions, strategic fit/relationship with our other core operations, political/regulatory risk and other such considerations. If those considerations are encouraging, we will conduct an economic analysis of the project, including evaluation of the applicable tax attributes. At that point, the evaluation becomes a numerical exercise, in which the object is to determine whether the project can meet or exceed certain economic metrics, to determine whether the project, given all the variables mentioned above and many more, makes economic sense. Certainly, the tax burden plays a large role in this numerical evaluation, and can, in some instances, render a project non-viable. As the tax burden increases, so will the number of uneconomical projects increase.

3. Would you support a review of all business and individual tax provisions in the context of broad tax policy reform?

Response:
We believe overall corporate tax reform that promotes investment in the United States and improves the international competitiveness of domestic companies is desirable. Any broad corporate tax reform should include lower rates and eliminate the U.S. taxation of foreign earnings (since they have already been heavily taxed in host nations). We also believe that stable non-discriminatory tax rules should provide equitable treatment for all companies, including those in the energy industry.

REVENUE TO THE TREASURY

1. What amount have your companies spent in terms of bonus bids for lease sales and royalties going to the Treasury?

Response:
During the 5-year period from 2006 through 2010, ConocoPhillips paid more than $1.1 Billion to the U.S. Treasury, in the form of lease rents, royalties and bonuses.

HELPING OPEC

1. Is the U.S., relative to other countries, a high cost place to conduct oil and gas operations?

Response:
Yes. The U.S. is already less competitive than many other areas of the world due to its higher costs. U.S. finding and lifting costs were 35% higher than foreign finding and lifting costs, according to U.S. DOE Energy Information Administration (EIA) data from 2007 to 2009. Finding and lifting costs for the U.S. offshore were also 76% higher than average worldwide costs for major oil and gas producers in EIA's data base. Increasing taxes would further reduce the competitiveness of domestic investments.

Additionally, lease bonuses are a higher share of the U.S. government's take in the Federal Outer Continental Shelf than in most other countries, according to petroleum tax

consultant Daniel Johnston[3]. In present value terms, bonuses are about three times more costly to firms than royalties, because bonuses are paid up front rather than deferred until development yields production. Bonuses are also more risky than royalties, since they are often paid for acreage that is ultimately unproductive. Consequently, the high cost structure of the U.S. constrains the amount of government take that domestic projects can bear and still remain economic.

ALTERNATIVE ENERGY PRODUCTION

1. How will tax increases as proposed in S. 940, impact your companies' investments in alternative energy?

Response:
An increase in our tax burden will, necessarily, decrease the amount we have available for investment. One can reasonably conclude, therefore, that additional capital constraints, caused by higher taxes, will have a negative impact upon future investments in alternative technologies.

[3]Daniel Johnston & Co., Inc., "Analysis of Government Take in the United States Outer Continental Shelf," January 10, 2008

Questions for the Record

Senator Tom A. Coburn, MD

Senate Committee on Finance: "Oil and Gas Tax Incentives and Rising Energy Prices"
Response from James J. Mulva, Chairman and Chief Executive Officer of ConocoPhillips
May 12, 2011

The following Questions are directed for each of the Committee's witnesses

1) In light of the budget crisis our country faces, would your company be willing to take a cut to help the country?

Response:
We believe that a responsible, comprehensive reform of the United States' income tax system is very important, in the effort to help our country recover from the financial crisis and to address the problem of our national debt. We understand that real tax reform will necessarily involve "base-broadening," coupled with reductions in statutory income tax rates, in order to eliminate many of the provisions that make the current system overly-complex and burdensome. We believe overall corporate tax reform that promotes investment in the United States and improves the international competitiveness of domestic companies is desirable. Any broad corporate tax reform should include lower rates and eliminate the U.S. taxation of foreign earnings (since they have already been heavily taxed in host nations). We also believe that stable non-discriminatory tax rules should provide equitable treatment for all companies, including those in the energy industry.

2) Would you be willing to forgo each of the industry's tax advantages altogether if the following were true:

   A. federal assistance for alternative energy was also eliminated to ensure true competition among technologies;

   B. the corporate tax rate for all industries was reduced to establish a competitive business environment;

   C. energy companies were allowed to fully access our nation's extensive natural resource deposits—including in ANWR, the Outer Continental Shelf, the Gulf of Mexico, and the various shale plays across the country;

   D. the regulatory process for energy leasing was streamlined—particularly as it relates to environmental permitting?

Response:
In the case of our company, the list of "tax advantages" available to us is very limited. Those who would seek to raise taxes on the oil and gas industry frequently label various items as "oil and gas tax subsidies," or "tax advantages," even though most of the

targeted items are broadly available to other taxpayers in other industries. In some cases, we are already more limited in our ability to claim these items than are other industries, or even other companies within our own industry. Regarding the context in which we would consider forgoing these items, please refer to the answer to Question 1.

If one considers the Administration's 2012 Budget Proposal, there are eight items listed in that document under the heading "Eliminate oil and gas preferences." Of those eight items, only two items, intangible drilling costs and the domestic manufacturing deduction, have any significant impact upon ConocoPhillips.

The deduction for intangible drilling costs (IDC) simply allows drillers to deduct the costs associated with drilling activity on oil and gas wells. These costs are largely comprised of labor and other costs which do not produce a tangible, depreciable asset, but are incurred simply for the purpose of drilling a hole in the ground, in order to determine whether oil and/or gas exist beneath the surface. The deduction for IDC does not include the cost of the tangible assets put in place after drilling, which are used to actually produce the oil or gas. IDC costs are closely analogous to the expenses incurred by many industries in conducting research and development (R&D), in order to determine whether they have a commercially viable product. R&D costs are fully-deductible, and in many cases, result in an additional credit against taxes. Perhaps the most significant difference between ConocoPhillips' tax treatment of IDC and the tax treatment of R&D costs is the fact that ConocoPhillips and other major, integrated oil and gas companies are already denied a current tax deduction for 30% of such costs. Non-integrated oil and gas companies may deduct 100% of their IDC.

The domestic manufacturing deduction (Section 199) is another tax provision which applies broadly to all manufacturers and producers in the United States – not just oil and gas companies. While this provision is often touted as an "oil and gas tax subsidy," the fact is that oil and gas companies benefit less from this provision than other industries. The provision generally allows, subject to certain limitations, a deduction equal to 9% of the taxable income from domestic production activities, but oil and gas companies are only allowed a deduction of 6% of that income. The 3% rate differential for oil and gas companies was enacted as a revenue-raiser as a part of the TARP legislation in 2008.

The other so-called "tax advantages" or "oil and gas preferences" included in the Administration's Budget Proposal are either not applicable, or are of such small consequence, to ConocoPhillips as to be irrelevant. One provision not included in that list which is often included among proposed oil and gas tax increase proposals is the modification of the dual capacity taxpayer rules. The Administration's Budget Proposal includes this change in the "reform" section related to international tax rules. The existing dual capacity provisions impose a limitation on the ability of dual capacity taxpayers (a group which consists almost entirely of oil and gas companies) to claim the credit for foreign income taxes paid abroad. All companies and individuals, regardless of their industry, or the nature of their income, who earn income outside the United States are entitled to claim the foreign tax credit. Dual capacity taxpayers, however, are subject to a more rigorous and restrictive set of rules than those applicable to all other taxpayers,

and oil and gas company dual capacity taxpayers are subject to an additional (some would say, "duplicative") set of rules limiting their ability to claim foreign tax credits.[1] The proposed modifications to the dual capacity rules would eliminate or significantly reduce foreign tax credits for oil and gas companies. [Note that some proposals, such as Senator Menendez's recent bill, S. 940, would effectively only impose these limitations on the three largest U.S.-based oil and gas companies.] This reduction in foreign tax credits would result in double-taxation of U.S.-based companies, rendering them, and the U.S. jobs that those activities provide, uncompetitive versus their foreign-based competitors.

While the basis for these additional proposed restrictions may sound compelling, i.e., that U.S.-based companies are allowed to claim a foreign tax credit for "royalties" or other payments made to foreign governments, which are not taxes, the fact is that the existing dual capacity rules were designed to address that very issue, and those rules are quite effective. They create a presumption that any dual capacity taxpayer who pays tax to a foreign government which exceeds the rate of tax generally paid by other taxpayers must prove (in court, if necessary) that the additional tax paid is not in exchange for a "specific economic benefit," i.e., a royalty. It is also a fact that the Joint Committee on Taxation has never listed the dual capacity provisions as a "tax expenditure," and has, in fact, acknowledged that the proposed changes can result in double-taxation. The "disguised royalty" argument is based upon the erroneous assertion that no government would levy a true tax on a single industry which exceeds the rate of tax paid generally, by other industries and taxpayers. The Joint Committee on Taxation also disagrees with this assertion, noting that an immobile industry, such as oil and gas extraction, may very well be subject to higher rates of tax than more mobile industries, because the mobile industries may simply "move out" of the high tax jurisdiction, whereas oil and gas companies must operate where the oil and gas exists.[2] In short, even the Congress's own tax experts agree that the fundamental premise underlying the effort to raise oil and gas company taxes by disallowing foreign tax credits is flawed.

Given the foregoing explanations, we feel that we have very few "tax advantages" to forgo in exchange for the changes and benefits listed in items A. through D. above. In fact, it is difficult to find a definition of the word "advantage" which would apply to any tax treatment under which the party in question benefits less than all others. Most would refer to that as a "disadvantage." Having addressed the concept of our "tax advantages," however, we believe overall corporate tax reform that promotes investment in the United States and improves the international competitiveness of domestic companies is desirable. Any broad corporate tax reform should include lower rates and eliminate the U.S. taxation of foreign earnings (since they have already been heavily taxed in host nations). We also believe that stable non-discriminatory tax rules should provide equitable treatment for all companies, including those in the energy industry.

---

[1] Joint Committee on Taxation, Description of Revenue Provisions Contained in the President's Fiscal Year 2012 Budget Proposal, Page 269.
[2] Id, page 272.

3) The American Petroleum Institute estimates the 9.2 million employees in the oil and gas industry earn over $90,000 per year (upstream and downstream job average—not including retail station sales). One of the nations largest independents employing over 5,000 pays its employees: (1) $176,000 per year for engineers, geologists, etc.; (2) $138,000 per year for professional staff, such as accountants, human resources, etc.; and (3) $52,000 for clerical and administrative staff

   What is the average salary for your employees?

   Response:
   Our Compensation and Benefits department participates in annual surveys of total compensation data (base salary, variable bonus, and long-term incentives) with our peer companies which are administered by a third party. Participation in these annual surveys allows us to ensure we are competitive with our peer companies. We agree with the basic assertion implied by your question, i.e., that our industry provides many high-paying jobs, and contributes in a substantial way to the U.S. economy and to the financial security of our employees and the communities where we operate, and we are proud to be a key participant in that contribution.

4) What are the three things Congress can do to lower gas prices?

   Response:
   Since the principal component of gasoline cost is the cost of crude oil, anything which can be done to increase the supply of crude oil should put downward pressure on crude oil prices, and consequently, upon gasoline prices. Given that premise, Congress can enact legislation which will:

   1) open previously off-limits areas to new oil and gas exploration and production;
   2) rein in wasteful and counterproductive regulatory burdens on the oil and gas industry, while maintaining important and productive standards of safety and environmental protection; and
   3) reform the income tax system, to make the U.S. system more globally competitive and eliminate the disparate tax treatments among foreign versus domestic taxpayers, among different industries and among taxpayers within the same industry.

   We believe that each of these items will have a positive impact upon the amount of crude oil produced in the United States and beyond, and could result in greater supply of crude oil and, therefore, lower prices.

5) What was your effective tax rate last year?

   Response:
   ConocoPhillips' effective tax rate for 2010 was 42%

6) What is your total tax benefit that you receive from the provisions targeted by recent proposals to eliminate existing tax advantages for your company?

Response:
Please refer to the response to question 2) above. We do not believe that we have any significant benefit from items which can be accurately described as "tax advantages;" however, in response to a similar question from Senator Cantwell, we prepared a table which shows the amounts deducted by ConocoPhillips, related to the oil and gas items listed in the Administration's Budget Proposal. That table is attached, for your reference in determining the tax benefit associated with each of those items.

The final question is directed towards Mr. Tillerson, Chairman and Chief Executive Officer, Exxon Mobil Corporation:

7) The proposals to eliminate oil and gas tax advantages are estimated to raise $18.54 billion over five years. Meanwhile, the cost of the Volumetric Ethanol Excise Tax Credit (VEETC) has cost over $24 billion over the last five years and will reach $30 billion if left intact through 2011.

As a blender of ethanol—if not the largest of them—would eliminating the VEETC be a logical first step in eliminating oil and gas tax advantages, especially considering ethanol has already been granted a guaranteed market share by Congress?

Response:
Since this question is directed to Mr. Tillerson, we have not provided a response.

Statement of

Marvin E. Odum

President, Shell Oil Company

before the

United States Senate Committee on Finance

Thursday, May 12, 2011

Chairman Baucus, Ranking Member Hatch, and members of the Committee:

I am Marvin Odum, president of Shell Oil Company. Shell is a global energy company, with more than 90,000 employees in more than 90 countries. Approximately 19,000 of those employees are here in the U.S. working to discover, produce, market and deliver to consumers today's energy and tomorrow's energy technology. Thank you for the opportunity to speak today.

I'd like to address right up front the issue that's on many American's minds – the rising cost of energy, particularly the cost of gasoline.

Because fuels are refined from crude oil, the biggest impact on the price of fuel is the price of crude oil.

Everything from the weather to politics and the global economy determines the price of oil and the fuels made from it. **No one person, organization or industry can "set" the price for crude oil.** Weak economic conditions in 2008 and 2009 lowered demand, which helped push prices down. Now, with worldwide economic recovery underway, demand is on the rise, sending prices upward.

In addition, because oil is sold in U.S. dollars throughout much of the world, when the dollar becomes weaker, it takes more dollars to buy the same amount of oil.

Stated simply, oil is a global commodity. And oil companies are price takers, not price *makers*.

So while we can't predict or control the price at the pump, we do know that we can increase the stability of our energy future through a combination of efficiency gains and increased supply.

And the surest way to address a challenge of this magnitude is to focus on what we *can* control -- using "what we know" to safeguard against what we don't.

Without question, our government is facing significant challenges right now – in terms of economic security, energy security, and other challenges.

But when you have a deficit, be it energy or financial, your choices are quite simple– get more, or use less – and, most often, it is a combination of both that achieves the best result.

It can be tempting to assume that there is something to gain by taking more from a few. However, one must also balance the potential implications of increased industry costs on both supply and price. Alternatively, if policies are put in place

to allow the energy industry to be an economic growth engine for America -- developing our own resources -- we would see tens of thousands of new, well-paying jobs and billions of dollars in revenue for local, state and federal governments.

Some perspective:

Last year, Shell reported global earnings of $18.6 billion. We also invested some $29 billion, mostly in new projects to bring energy supply to the consumer, and spent more than $40 billion to run our businesses globally.

Last year in the Gulf of Mexico, government policies caused Shell to defer some $700 million in capital expenditures and take more than $180 million in special charges. We expect to lose an estimated 50,000 barrels of oil equivalent per day in 2011 alone. Thinking about that impact to-date, that represents lost gasoline production – just to Shell – that could have powered, on average, 633,000 cars and light trucks every day since January 1.

Here in the U.S., at the invitation of the federal government, we have invested more than $3.5 billion since 2005 to develop energy resources in Alaska. Six years later, we have been prevented from drilling a single exploration well due to the government's inability to deliver timely permits to allow this potential new

resource to be developed. During that time, we have drilled more than 400 exploration wells worldwide.

My point is this: Investments in our industry carry huge amounts of capital and risk. Policy makers must consider this when thinking about the competitiveness of the U.S. versus other regions.

The President recently acknowledged that reducing dependence on imports was a national policy imperative. We agree. The U.S. is resource-rich in many ways, especially in oil and gas. Yet, as a country we import more than 60 percent of our petroleum at a cost of more than $350 billion a year.

And the bottom line is this: if we don't develop our own energy sources, we'll have to accept the costs – both financial and geopolitical – of bringing it into this country from places that are less secure or less stable.

In closing, Shell is grateful for the widespread recognition in Congress of the daunting energy challenge facing the nation. Although some of our opinions differ, we all agree that it will take all possible energy sources and energy savings to meet demand.

We should also agree and acknowledge that oil and gas will remain critical sources of energy for decades to come. I urge you to consider the broad and sustained benefits of developing our own domestic resources.

Keeping this economic value here at home, we can at the same time move forward with investments in the next generation of technologies and energy solutions that will power the future.

Thank you and I look forward to your questions.

Senate Finance Committee Hearing
"Oil and Gas Tax Incentives and Rising Energy Prices"
May 19th, 2011
Questions for Mr. Marvin Odum

From Senator Baucus

1. Exxon Mobile has a recent posting by Ken Cohen, V.P. of Public and Government Affairs on its "policy blog" titled "ExxonMobil's U.S. taxes and U.S. earnings—Some relevant numbers for Washington. Mr. Cohen states that ExxonMobil had total tax expense of $9.8 billion in 2010 which exceeded total U.S. operating earnings of $7.5 billion. Footnote 18 of ExxonMobil's the 2010 Form 10-K filed with the SEC provides a breakdown of the total $9.8 billion. It includes $6.2 billion in "sales-based taxes".

   I would like to ask each of you to describe the nature and amount of these U.S." sales based taxes" that you include as a tax expense in your financial statements. Are they federal excise taxes that are included in the price at the pump and effectively paid by consumers? Also, are these amounts included in your total sales reported on the income statement and therefore offset the amount reported as an expense?

   If these taxes are effectively passed on to consumers, isn't describing them generally as taxes paid by your companies similar to a retailer claiming that they pay the state and local sales taxes that they collect from consumers and remit to the appropriate governmental authorities?

   With regard to sales based taxes, i.e., excise taxes, Shell includes such amounts in sales revenue (at the point of sale), and also includes such amounts in the cost of sales (incurred at the point of purchase). As a result, such amounts generally net out in the Shell Form 20F income statement, and are not reflected as a "tax amount" in Shell's 20F.

2. According to ExxonMobil's 10-K for 2010, for every 1 dollar increase in the price of oil, ExxonMobil earns a 375 million after-tax profit.

   Last year, the average price of a barrel of oil was 72 dollars. The price of oil today is around 100 dollars and is projected to average over 100 dollars for the year.

   Doing simple math, if prices do average 100 dollars this year, ExxonMobil stands to earn in excess of 10 billion dollars in additional profit in 2011 than in 2010 just due to the increase in the price of oil.

   In contrast, the total amount of tax breaks under consideration today is approximately 2 billion dollars for all the companies at the table combined.
   I'd like to know from the other four companies how much in after-tax profit you earn from each 1 dollar increase in the price of oil.

Wouldn't each of you agree that a price change of two or three dollars in a barrel of crude oil has a more meaningful impact on your investment decisions than your share of the effect of repealing all the tax provisions under consideration today?

Isn't the value of a price of oil the most important driver for your business planning?

Would you really consider producing less in the United States with the significant profits you earn with every additional barrel of oil produced?

While the price of crude oil can have an impact on earnings, investment decisions, and business planning, Shell does not issue reports on this basis.
Regarding the proposed tax repeals, Shell is in favor of a comprehensive review of tax policy that encourages economic growth, jobs and energy security. In contrast, these tax repeals discriminate against a small group of United States taxpayers and are contrary to good tax policy, to good economic policy, and to energy security. Development opportunities are competitive. Changing the tax structure to be less competitive runs the risk of driving development to other countries.

3. Some of the witnesses have testified that the oil and gas industry is already subject to high effective income tax rates. They refer to overall effective rates in excess of 40 percent. But these rates appear to be a weighted average of both U.S. and non-U.S. income tax rates applied to domestic and foreign earnings.
From financial reports filed with the SEC, it appears the effective U.S. income tax rates are significantly lower than the average foreign rates. It seems that the high foreign rates are pushing up the total reported effective rate. One of the companies stated in their financial disclosure that the weighted average statutory tax rate in countries in which they operate was 55.3 percent for 2010.

I would like to ask each of you what the U.S. tax rate is on just your U.S. income. And how does that compare to foreign tax rates you pay on your non-U.S. income?

Shell is willing to provide, upon request, non-proprietary information to the Committee. Shell does not disclose proprietary and confidential information relating to its tax returns; as such disclosure would subject such confidential information to public disclosure.

So isn't the U.S. actually a favorable income tax environment in which to engage in production, refining and distribution?

And wouldn't that still be the case, even if these subsidies did not exist?

The United States is in a position today where it is competitive and attracts investment in the Upstream oil and gas business. However, if investment in the United States is disadvantaged (vis-à-vis tax increases) relative to other opportunities in the world, then investment will move elsewhere. Regarding Downstream activity, the United States' corporate tax rate of 35% puts Downstream businesses at a competitive disadvantage in relation to countries that have lower corporate income tax rates.

4. Current tax rules arguably allow foreign tax credits for payments that are economically equivalent to royalties.

   The proposal under consideration would limit creditable foreign taxes to generally applicable foreign taxes.

   The three largest US oil companies are on pace to earn 80 billion dollars in aggregate profit in 2011. Making the proposed changes to the foreign tax credit rules would cost your companies less than one percent of that profit.

   Is it a serious problem for your company to pay less than 1% of your profits for the proposed modification?

   Shell does not believe that any of the proposed modifications are sound from a U.S. tax and energy policy perspective.

5. In 2005, the then-CEO of your company testified at an Energy and Natural Resources hearing, and stated that the tax breaks "were not material in any way" for your company. Why, then, should we provide such incentives?

   This answer provided at the Energy and Natural Resources Committee hearing concerned the Energy Policy Act of 2005 ('EPACT') and specifically to oil and gas changes made therein—not oil and gas provisions in general. The proposed elimination of oil and gas deductions that is currently being suggested by some in Congress concern items of tax law that are different from changes made in EPACT.

6. Mr. Odum, in your testimony, you say: "No one person, organization or industry can set the price for crude oil."
   Instead, you claim that oil is a global commodity, and therefore the oil companies "can't predict or control the price at the pump." Just yesterday, the nonpartisan Congressional Research Service confirmed your statement when it said:
   "The price of oil is determined on world markets and tends not to be sensitive to small cost variations experienced in regional production areas…Prices are well in excess of costs and a small increase in taxes would be less likely to reduce oil output, and hence increase gasoline prices"

   Others in your industry have argued exactly the opposite. They say that any tax increase on oil companies will result in an increase in the price of gasoline. In fact, the American Petroleum Institute (of which you are a member) recently claimed that ending tax breaks for oil companies would increase the price of gasoline by 1.6 cents.

   Mr. Odum, how do you respond to others in your industry that say ending these tax breaks will boost prices at the pump when you concede that oil companies cannot control the price of oil?

The question raises separate issues. One issue has to do with whether oil companies control oil prices, which they do not. The marketplace determines the price of oil. The second issue is whether changing U.S. tax policy to be less competitive would place upward pressure on the marketplace with regard to prices. Shell believes that it could. Keeping U.S. tax policy stable and thus keeping the United States competitive would better enable us to develop our own resources, and thus we would see tens of thousands of new well-paying jobs and many, many billions of dollars in revenue for local, state and federal governments. Investments in our industry carry huge amounts of capital and risk. Policymakers must consider this when thinking about the competitiveness of the U.S. relative to other regions. The president recently acknowledged that reducing dependence on certain imports was a national policy imperative. And Shell agrees. The U.S. is resource-rich in many ways, especially in oil and gas. Yet, as a country, we import more than 60 percent of our petroleum at a cost of more than $350 billion a year. The bottom line is this: If we don't develop our own energy sources, we will have to accept the cost, both financial and geopolitical, of bringing it into this country from places that can be less secure and less stable. With a real energy policy that provides incentives through its access to those resources, we could have a significant impact on the economy, the deficit, and the trade balance. If the production in the United States is disadvantaged relative to other opportunities in the world then it moves somewhere else. Therefore, the jobs move somewhere else. The trade benefits move somewhere else.

From Senator Baucus on Behalf of Senator Reid

1. How much did your company spend in 2010 in the US on the research, development, demonstration or domestic production of clean, non-petroleum-based alternative transportation fuels? Please also identify the amount by which that estimated expenditure was effectively reduced through Federal tax deductions or tax credits, such as the research and development tax credit, claimed by the company.

   Shell is willing to provide, upon request, non-proprietary information to the Committee. Shell does not disclose proprietary and confidential information relating to its tax returns; as such disclosure would subject such confidential information to public disclosure.

From Sen. Wyden

1. When arguing for opening up US lands and waters for oil drilling, the oil industry complains that because most oil is controlled by foreign governments, the US oil industry has no place else to go for access to oil and gas resources except in the US. But at today's hearing, you testified that if you lost the tax breaks you currently receive, more oil exploration and production would go offshore.

   How can you claim both that you have no place else to go to drill for oil outside the US and that if you lose tax breaks you'll move operations offshore? Isn't that a contradiction?

The United States is in a position today where it is competitive and attracts investment in the Upstream oil and gas business. However, if investment in the United States is disadvantaged (vis-à-vis tax increases) relative to other opportunities in the world, then investment could move elsewhere.

2. During this morning's hearing, Mr. McKay responded that he agreed that it was appropriate to phase out the ethanol blending credit in light of the statutorily-mandated renewable standard requirement. Do you agree with Mr. McKay that it is time to phase out the ethanol blending credit?

   Yes.

From Senator Thune

1. I want to discuss a particularly promising area of our country for domestic energy production, the Williston Basin located under parts of North Dakota, South Dakota, Montana and Canada. Some have called this area "Kuwait on the Prairie" because it holds the largest oil and gas find in North America since the Prudhoe Bay discovery in Alaska in the 1960s. Can you comment on the potential for job creation and economic development in the states I mentioned related to these oil and gas reserves. Would the tax increases in the President's budget and the legislation sponsored by Senator Menendez make you more or less likely to increase domestic production from these reserves, were these tax increases to be enacted into law?

   Shell does not currently have plans to invest in exploration and production in North Dakota, South Dakota or Montana. Although Shell cannot comment directly on the economic impact of development in these states, Shell can provide some compelling information related to the value of developing Alaska's offshore oil and gas resources. Offshore Alaska holds world-class oil and gas potential. DOI has estimated that the Alaska OCS holds 27 billion barrels of undiscovered technically recoverable reserves. This compares to 17 billion barrels that have been produced from Prudhoe Bay and 3-4 billion barrels of technically recoverable barrels in the Bakken formation in the Williston Basin. Shell spent nearly $2.2 billion to acquire leases from the federal government and has invested an additional $1.5 billion to prepare for an exploration program. Analysis by the University of Alaska shows that developing Alaska's Outer Continental Shelf (OCS) will create an annual average of almost 55,000 jobs for at least fifty years. Nearly half of these jobs will be in contiguous United States. Jobs related to developing Alaska's OCS are estimated to peak at over 90,000.

   Domestic oil and gas development is an economic engine that creates jobs, contributes to the nation's energy needs, generates revenue for local and national government and addresses the balance of trade issue. Data show that the industry employs, directly or indirectly, over 9 million Americans. The jobs and associated with development work create economic activity. Economic activity creates government revenue. Assuming price of oil is $80 per barrel, the total government revenue generated by developing

Alaska's OCS would be $214 billion, with the vast majority going to the federal government; a critical factor to America's deficit reduction.

Shell is a global company. In making investment decisions, Shell evaluates opportunities around the world. Our projects typically have a long-lead time from final investment decision to first oil. Further, our projects typically require hundreds of millions in capital expenditures before coming on line. For this reason, Shell carefully scrutinizes each investment opportunity. Many criteria are evaluated including the fiscal terms and the stability, predictability and fairness of the legal and regulatory framework.

Shell opposes proposals that seek to increase taxes on a small group of companies in the oil and gas industry simply based on the fact that the companies are large. Should Congress approve such discriminatory legislation, it will be factored into Shell's future U.S. investment decisions.

From Senator Rockefeller

1. What was the average annual compensation for your company's top 5 executives over the past decade? Last year?

   In 2005, Shell underwent a major structural reorganization, in which the two publicly held companies (Royal Dutch and Shell Transport and Trading) were succeeded by one public company (Royal Dutch Shell, or "RDS").
   The average over the past 6 years was slightly over $4.3 million and the average in 2010 was slightly over $5 million.

2. What is the single most important tax incentive your business receives? Why?

   Shell is willing to provide, upon request, non-proprietary information to the Committee. Shell does not disclose proprietary and confidential information relating to its tax returns; as such disclosure would subject such confidential information to public disclosure.

   Shell believes in making the United States a more attractive place to invest, and does not believe that any of the proposed modifications would do that, as they are not sound from a U.S. tax and energy policy perspective.

3. Two of your highest dollar tax incentives are Dual Capacity and Intangible Drilling Costs. Which of these two provisions is more important to your company and which you would choose to live without if Congress is forced to choose between the two?

   Shell is willing to provide, upon request, non-proprietary information to the Committee. Shell does not disclose proprietary and confidential information relating to its tax returns; as such disclosure would subject such confidential information to public disclosure.

Shell believes in making the United States a more attractive place to invest, and does not believe that either of these proposed modifications would do that, as they are not sound from a U.S. tax and energy policy perspective.

4. Some of you talk in your testimony of discriminatory treatment for your industry. It is my belief your industry has received preferred treatment for a century. Depletion goes back to 1916, and your industry was not eligible for the manufacturing subsidies that the section 199 subsidy replaced. Yet your companies' lobbying efforts allowed you to benefit from 199 when enacted. How do you reconcile such special treatment with claims of discrimination?

   Shell believes in making the United States a more attractive place to invest, and does not believe that any of the proposed modifications would do that, as they are not sound from a U.S. tax and energy policy perspective. Risk and annual multi-billion dollar oil and gas investments are key reasons to keep the section 199 manufacturing deduction and other oil and gas deductions in place for the oil and gas industry, and not just select taxpayers. As a large manufacturer, the oil and gas industry should be entitled to the full section 199 manufacturing deduction, similar to other U.S. manufacturers.

From Senator Roberts

1. Understanding that the five companies appearing before us today are all publicly traded, and are about 98% owned by individuals or institutional investors who are managing pension funds, mutual funds and IRAs for millions of middle class Americans that rely on these holdings for their economic security and retirement; what impact do your companies' record profits this past year have on middle class Americans whose economic portfolios invest in U.S. integrated oil companies?

   Total Shareholder Return was 17% in 2010 (including $9,584 million in dividends paid to Royal Dutch Shell plc shareholders worldwide, excluding scrip dividends), and 22.6% in 2009 (including $10,526 million in dividends paid to Royal Dutch Shell plc shareholders).

2. How significant of a role does certainty in tax policy play for your companies when making investments decisions regarding greater domestic production and, more importantly, when hiring new employees?

   Energy companies depend on stability and certainty when making annual multi-billion dollar investments. Changes to tax laws can make projects unattractive and /or cause delays in the development of such projects. Tax provisions that would depress U.S. oil and gas exploration and production investment are contrary to the goals of providing stable and cost effective supplies of energy for American consumers. Such tax provisions also discourage the tremendous capital investments needed to meet the nation's growing energy needs. History has shown that windfall profit type taxes and other discriminatory

types of taxes on the investor owned oil and gas companies will cost U.S. jobs, make U.S. industry less competitive, and will have a negative impact on U.S. energy security.

From Senator Snowe

1. With prices as high as $100 the question today is whether our energy tax policies are effectively creating incentives to change behavior – rather than simply making cost-effective business decisions only more profitable.

   As a result, I find it interesting that in an analysis last year of the implications of removing these tax incentives that the American Petroleum Institute included an assumption that oil is at $80 per barrel. The analysis, done by Wood and Mackenzie, concluded that removing these tax incentives would alter the "breakeven" point for oil - that is the cost for profitability - from an average of $47.00 per barrel to $52.00 per barrel – or 10 percent.

   In addition, the report's executive summary concludes that under scenarios where oil is higher than $80 the removal of oil and gas subsidies would not affect oil production at all. While I recognize that additional subsidies lead to additional production, it would seem that there would be decreasing returns from more and more subsidies for US oil production.

   Specifically, while the report states concerns about the effects on natural gas production with the removal of subsidies the report states, "The impact to the oil market is much lower, as less than 60,000 barrels are at risk under the proposed changes in 2011." Effectively, the report concludes that if oil is priced at points higher than $80 per barrel the removal of these incentives will not result in any lost oil production.

   At a time when oil is priced at roughly $100 – and if these prices were to continue – do you agree with the API report that there would not be any reduced production of oil in the United States if the tax incentives were removed?

   Do you support removing these tax subsidies for oil at a certain point, perhaps the long-term level that EIA or your companies predict that oil will be in 5-10 years?

   Production decisions and impacts are based on many different factors. Investments that have to be made to produce oil and gas include not only the huge investments -- the billions of dollars that go in -- but also the time lag from when those investments start to when that production actually starts to happen. A discussion of tax policy dealing with oil and gas activity must consider this fact. While it is difficult to predict with certainty the extent production could be reduced under these new tax proposals, changing the U.S. tax structure to be less globally competitive is not sound from a U.S. tax and energy policy perspective. Regarding long term opportunities, Shell is in favor of a comprehensive review of tax policy that encourages economic growth, jobs and energy security.

2. We have witnessed the continued volatility of our energy futures markets, with for instance gasoline prices falling 7.6 percent on May 11th, 2011, coming during a year when gasoline has increased by more than 28 percent. The development yesterday came when the U.S. Department of Energy surprised traders by reporting an unexpected buildup of gasoline stockpiles in the previous week.

   This situation yesterday raises two critical questions regarding the efficiency of our energy markets. First, as the Commodity Futures Trading Commission is considering now, should we adopt position limits for particular traders to reduce the volatility of specific contracts. As a leader, along with Senators Feinstein and Cantwell, on developing a strong derivative title within the financial reform bill, I strongly believe transparency and restrictions on specific trades will not restrict price discovery, but will reduce volatility and potential for manipulation.

   Secondly, trading on May 11th again demonstrates how critical it is for an efficient market to have access to accurate and timely data. This is not like any other market – information regarding consumption, production, and reserves are controlled, in some instances, by America's adversaries.

   For instance, just last month the Wall Street Journal reported that "unreliable data on production, starting with the world's largest exporter, are adding to the price volatility..." and that the "revelation highlighted a problem that is roiling markets at the moment: a dearth of solid information about the true state of production and supplies."

   As a result of these developments do you believe that the CFTC should adopt strict position limits for speculative traders and do you believe that there is enough transparency in these markets to accurately assess efficient pricing of oil?

   Arguably, position limits are not the solution. If the intention of applying "strict" position limits is to prevent potential manipulation, Shell would suggest that there are mechanisms and controls that can identify and control inappropriate trading behavior more effectively than position limits. Reporting will be helpful in this regard, but the cost/benefits of the amount of information requested needs to be considered. If the intention is to reduce volatility, then Shell would suggest that there is no conclusive evidence that position limits reduce volatility.

   The CFTC has proposed to adopt what appear to be very tight aggregate position limits on 28 types of commodity contracts, including 4 types of energy contracts. Entities that need to hedge large physical positions will be allowed to hold larger positions than speculators, but the details about how that "hedge exemption" process will work are unclear, raising concerns that some parties may not be able to hedge all the risk that they are exposed to.

   Finally, it is important to recognize that market participants enter speculative positions for different reasons. "Herd mentality" speculators, including the so called "massive passives" do not aid price discovery. On the other hand, speculators who take derivative

positions based on their informed views of fundamental conditions and economic events improve price discovery. Position limits do not recognize this important difference. There is no question that successfully established futures markets are highly transparent (particularly in the nearby time periods) and afford access to parties to risk manage future consumption and production, which is positive for the efficient functioning of the supply chain. Strict position limits on speculators who respond to supply/demand fundamentals may impede some of this transparency.

Do you believe that current prices are reflective of supply and demand?

Futures prices have to reflect supply and demand but will also reflect the uncertainties around these fundamentals. In times of political or economic tension this may create a risk premium or discount in futures markets depending on the exact nature of the tension. Additionally, futures prices may reflect "herd mentality" speculation, which can exacerbate highs and lows when all the money is going one way. This may be driven by several factors including cash coming into the "asset class" as other investments do not look good or attempts to diversify. Ultimately, however, the cash price paid for commodities has to reflect supply and demand.

Do you believe that foreign countries are doing enough to supply the world with information about reserves and production and what can the United State government do to facilitate information sharing?
Accurate and verifiable information on supply, reserves, and demand aides in price discovery, however, it will not reduce volatility. Price changes in the oil markets are driven by many other factors besides this sort of information. Those factors include interest rates, transportation costs and economic developments.

3. The Tax Reform Act of 1986 is constantly referred to as a model for tax reform and the point often made any new reform we undertake should follow its lead, which was to broaden the base and to reduce tax rates. The phrase "broaden the base" is just a clever way of saying "eliminate tax provisions" such as credits and deductions that clutter the code in order to simplify the code and to provide the revenue needed to offset the corresponding reduction in tax rates.

   The Democrats have presented us with an opportunity to broaden the base by eliminating certain tax provisions, namely, the tax benefits that are available currently to the five companies before us today. But instead of lowering the rates, the plan is to use the revenue from these cuts to pay down the deficit – just another way avoiding the spending cuts that the American people recognize has led us to these deficits.

   The Finance Committee has held a series of tax reform hearings and I thank Chairman Baucus for that. One thing we have learned is that the tax code is filled with too many special provisions and today we are debating yet one more complication to a tax code that is screaming for simplification.

What we should be pursuing is a comprehensive energy plan at the same time we pursue comprehensive tax reform. There is wide agreement that the rates are too high for our American companies to remain competitive – even the Obama Administration has suggested cutting corporate tax rates. We could start to do so today, with a down-payment made on such rate reductions by the elimination of the oil and gas provisions currently on the table.

We have to ensure the competitiveness of American companies and cutting the tax rate is one goal where we already have some consensus. We just need to agree on how to get there. Do you agree that reducing tax rates would justify the elimination of the oil and gas tax provisions we are discussing today? Do you think that rather than stop with these oil and gas provisions, we should also eliminate other energy subsidies in order to provide the broadest possible rate reductions?

Tax provisions that would depress U.S. oil and gas exploration and production investment are contrary to the goals of providing stable and cost effective supplies of energy for American consumers. Such tax provisions also discourage the tremendous capital investments needed to meet the nation's growing energy needs. History has shown that windfall profit type taxes and other discriminatory types of taxes on the investor owned oil and gas companies will cost U.S. jobs, make U.S. industry less competitive, and will have a negative impact on U.S. energy security. Keeping U.S. tax policy stable and thus keeping the United States competitive would better enable us to develop our own resources, and thus we would see tens of thousands of new well-paying jobs and many, many billions of dollars in revenue for local, state and federal governments. Investments in our industry carry huge amounts of capital and risk. Policymakers must consider this when thinking about the competitiveness of the U.S. relative to other regions. The president recently acknowledged that reducing dependence on certain imports was a national policy imperative. And Shell agrees. The U.S. is resource-rich in many ways, especially in oil and gas. Yet, as a country, we import more than 60 percent of our petroleum at a cost of more than $350 billion a year. The bottom line is this: If we don't develop our own energy sources, we will have to accept the cost, both financial and geopolitical, of bringing it into this country from places that can be less secure and less stable. With a real energy policy that provides incentives through its access to those resources, we could have a significant impact on the economy, the deficit, and the trade balance. If the production in the United States is disadvantaged relative to other opportunities in the world then it moves somewhere else. Therefore, the jobs move somewhere else. The trade benefits move somewhere else.

From Senator Enzi

1. You all indicated that you were in favor of overall corporate tax reform. In that regard, I have three questions:

   If Congress were to take up corporate income tax reform and eliminate provisions of the tax code that benefit traditional and alternative energy industries, to what rate would the corporate income tax need to be lowered to avoid a net tax increase on your company?

While I support the ideas of individual and corporate tax reform, I am concerned that a dramatic change in our tax code will be problematic for companies and individuals who have done long term tax planning. Do you agree with my assessment that there needs to be a phase in period? If so, how long should that phase in period be? If not, please explain how your company would handle such a change in the tax code.

Are there any provisions of the tax code that you would prefer not be changed if we were to lower the corporate tax rate as a part of overall corporate tax reform?

We are currently reviewing the impacts of potential U.S. tax reform. Any reduction in the tax rate will have to be weighed against specific base changes. In addition, transition rules and grandfathering provisions will be needed to mitigate against economic hurt from any immediate changes, given the long term investments made.

From Senator Cantwell

1. The discussion of tax subsidies and incentives in the May 12, 2011 Finance Committee hearing was largely an abstract one on the overall economic and societal costs and benefits that result from these measures. I would appreciate having more specific information on the extent to which your firms have benefited from the tax provisions being discussed over the last decade. For your respective firms, would you please provide auditable data on your company's utilization of each of the following categories and for each of the past ten years (2000-2010):

    - Enhanced Oil Recovery Credit
    - Credit for Oil and Gas from Marginal Wells
    - Expensing of Intangible Drilling Costs
    - Deduction for Tertiary Injectants
    - Passive Loss Exception for Working Interests in Oil Properties
    - Percentage Depletion for Oil and Natural Gas Wells
    - Domestic Manufacturing Deduction for Oil and Natural Gas Companies
    - Geological and Geophysical Amortization
    - Net annual profit

    Shell is willing to provide, upon request, non-proprietary information to the Committee. Shell does not disclose proprietary and confidential information relating to its tax returns; as such disclosure would subject such confidential information to public disclosure.

2. I think we can all agree that America's future prosperity and competitiveness is contingent on figuring out how we can live within our means while providing our businesses more predictability and stability in the marketplace, in part by providing a more level playing field for all market participants. I would argue that one thing we can do is to ensure that U.S. industries all receive equal treatment under the federal tax code so that they operate on an equal footing. I don't understand, for example, why oil companies should be allowed to write off the costs of machinery and other so-called

"intangible costs" immediately, while companies in other industries have to write off these expenses gradually, over the lifetime of the equipment they purchase. Likewise, a few years ago, Congress to redefine the word "manufacturing" so that oil companies could take advantage of a manufacturing tax deduction for oil production.

I was intrigued by an argument that Mr. Watson made in his testimony, which if I understood him correctly, argued that we should not change tax breaks for the oil industry outside of a broader context of corporate tax reform.

Does that mean that you might all be willing to work with Congress to figure out ways to simplify and reform our nation's byzantine tax code in the interest of replacing the myriad of tax expenditures we are discussing here today with lower overall corporate tax rates for all industries?

Shell would be willing to work with Congress on U.S. tax reform.

3. Considering all the uncertainties that affect your industry and the United States as a whole, would you support efforts to create a policy framework which provides greater certainty and stability when it comes to energy prices, regulation, and supply and demand fundamentals? I believe that is an important question because eventually Congress will regulate greenhouse gas emissions. This moment may come as soon as next year if the DC Circuit throws out EPA's tailoring rule. Would your companies support be supportive of legislation that established a price on carbon in a manner that was transparent, market-based, technology and fuel neutral, and economy-wide, as an alternative to EPA regulation of greenhouse gases?

   Shell certainly values regulatory certainty and stability. These are important components for any long-range business planning. Shell would need to see the details of any policy framework regarding price, regulation, supply and demand before we could speak to possible support for such a framework.

   Shell believes a carbon price is necessary to effectively reduce greenhouse gas emissions while encouraging the deployment of low-carbon technologies critical to a sustained, emission-reduction pathway. A market-based policy facilitates emissions reduction at the lowest possible cost to consumers and the economy. Shell prefers workable climate legislation to regulation by EPA under the Clean Air Act. The Clean Air Act is not well-suited to the regulation of GHGs. While conceptually, Shell could support market-based, economy-wide legislation that established a transparence price on carbon and did not disadvantage a particular fuel or technology, Shell must closely review any proposed legislation before a decision can be made on whether to support it.

4. Both the Joint Economic Committee and the Congressional Research Service produced analyses that show that removing tax expenditures to the oil industry as proposed in S. 940 will *not* lead to significant gasoline price increases or oil production decreases. To you agree with conclusions of these reports? And if not, please describe in detail the flaw or flaws in their analyses. Are there any independent studies that demonstrate that

eliminating these tax expenditures will significantly increase prices or reduce domestic oil and gas production? (Per correspondence with Senate Finance Staff, the change *in italics* has been made by the taxpayer in order to conform the question to the intent of Senate Finance Staff)

We do not agree with the conclusions of the JEC or CRS reports, given the long-term and cyclical nature of the industry and the annual multi-billion dollar new investment needed to produce oil and gas resources. Shell believes that domestic oil and gas development is an economic engine that creates jobs, contributes to the nation's energy needs, generates revenue for local and national government, and addresses the balance of trade issue. See the 2010 Wood McKenzie report titled "Evaluation of Proposed Tax Changes on the U.S. Oil and Gas Industry", which concludes that the proposed changes could impact oil and gas investment and production.

From Senator Menendez

1. According to the Energy Information Administration, the average cost to produce a barrel of oil is around $33; but SEC filings show that the average production costs for the Big 5 are much lower, at about $11. With a barrel of oil selling for around $100, why do you need subsidies? Can each of you tell the Committee and the American people what price per barrel and profit margin you will need to reach before these subsidies are no longer necessary?

   Shell does not receive tax subsidies for oil and gas activities. The Internal Revenue Code generally allows taxpayers, regardless of industry, to recover their costs as deductions against income from carrying on a business. The oil and gas industry is eligible for such deductions, which are similar to, if not the same as, deductions available to many other industries.

2. Please provide a detailed accounting of how many dollars your company did not pay in taxes as a result of the tax subsidies proposed to be eliminated in S.940, the Close Big Oil Tax Loopholes Act, for each of the last 5 years.

   Shell is willing to provide, upon request, non-proprietary information to the Committee. Shell does not disclose proprietary and confidential information relating to its tax returns; as such disclosure would subject such confidential information to public disclosure.

3. On November 19, 2009, you testified before the Senate Committee on Energy and Natural Resources that those that believe that the risks of coastal drilling are substantial have an "outdated view" of the risks. You said that "as we think about opening new areas of the OCS to exploration and production, I believe the way to look at it is to look at the latest developments by the industry in the current areas that are open...because that's where you see the new technology, and in addition, all the mitigation techniques and other things that we've learned over these decades." After I raised concerns about the 9 million gallons of oil spilled off Australia's coast earlier that year, you persisted and said: "I'm telling you, yes, it's very different today." But tragically, you and many others

in the coastal drilling business were very wrong. Months later the nation's worst oil spill began in the Gulf of Mexico after the explosion aboard the Deepwater Horizon drilling rig. Given the fact that you did not think the 2009 Australian spill could happen in US waters, but then a similar, but much worse spill happened, why should we trust you when you say your proposed drilling operations in Alaska will be safe?

In our November 2009 discussion, I said that the risks of offshore oil and gas development can be mitigated by using the technology, the techniques and the knowledge that we have available today. The Deepwater Horizon incident in the Gulf of Mexico was a tragedy. It should not have happened. It appears that the incident was the result of multiple failures in operational and process safety. The same can be said of the Australian incident. The technology exists to develop offshore oil and gas safely when applied within a good safety culture and system and applied by skilled and trained staff to achieve the intended results. Shell is confident in our technology, our internal standards, our training and importantly our safety culture and management and thus confident we can safely deliver the valuable energy that America needs while protecting the environment.

Senator Rockefeller Statement for the Record
Finance Committee Hearing on Oil and Gas Prices
May 12, 2011

Mr. Chairman, I know many Americans are furious about the rising cost of gas. $4 for a gallon of gas can mean almost $100 for a fill-up. That's too much.

Energy prices in West Virginia and across the nation have soared, placing an unstable burden on our economy and our daily lives.

Increasing gas prices are a challenge not only to our efforts to recover from the biggest recession since the Great Depression, but they also place unreasonable burdens on poor and middle-class families, businesses, and municipalities, and raise serious national security concerns.

In much of the country, gas prices are hanging over service stations like a dark cloud. Many working-class individuals in rural states like mine commute twenty-five miles or more each way, and high gas prices can eat heavily into their weekly paychecks.

I hear often from constituents who are experiencing sticker shock at the pump. Police departments, schools, hospitals, and community organizations feel the pinch of rising fuel costs. Even the smallest increase can have a serious impact on family budgets and a business's bottom line.

Talking with industry experts and economists has convinced me that a big factor in the rising cost of energy is the role of speculators. These individuals make a quick profit betting on future oil contracts. This may be legal, but I have asked the federal government to look closely at the role of speculators in the oil futures markets, and for the Commodity Futures Trading Commission to start implementing new laws requiring speculators to put some money down in these transactions – to reduce high-risk gambling at the public's expense.

The fact that a few people on Wall Street trying to make an easy profit can impact the price that regular people throughout the country pay for gas is unacceptable, particularly with gas prices headed steadily up. Oil speculation was also considered one of the root causes for why gas prices rose so much, so quickly in the summer of 2008.

I am not alone in thinking these speculators are driving up oil prices and creating more price volatility. In the Senate, we have asked the Commodity Futures Trading Commission to use their regulatory tools, such as position limits and margin requirements, as outlined in the Dodd-Frank Wall Street Reform and Consumer Protection Act. While this hearing today does not focus on this issue, I will remain active in trying to drive unscrupulous speculators out of the market.

At the same time that consumers are struggling, large oil companies continue to make record profits – while in many cases receiving billions of dollars in tax credits.

Last year, the five companies represented here today – BP, Chevron, ConocoPhillips, ExxonMobil, and Shell – made $77 billion worth of profits, and yet they will receive more than $36 billion of taxpayer subsidies over the next decade. This is a shame, and we must fix the tax code that allows these companies to walk away with this kind of gift, while we in Congress are working to reduce the deficit and some are pushing for cuts in health care for seniors, working families, and children.

This industry loves to argue that without these tax credits they'd be forced to raise gas prices. Baloney. The truth is that each of these companies have made $950 billion in profits over the past decade, more than enough to easily cover the costs of a lost taxpayer-provided subsidy without raising prices for consumers.

The per capita income for West Virginia is almost $33,000 a year. I think it's time these five companies gave those individuals a rebate at the pump rather than asking for another handout.

As Congress continues its work to address our unsustainable debt, we cannot – and should not – finance this effort by cutting back on important services to millions of Americans.

Working families are already struggling to make ends meet, and financing deficit reduction efforts on their backs while sending billions of dollars in subsidies to companies that do not need them is unconscionable. This sacrifice must be shared.

This is why I have opposed plans like the House passed Paul Ryan budget that ask working families to pay for trillions of dollars in tax cuts for the wealthy while also gutting Medicare and Medicaid. Whether it is unnecessary tax subsidies for the wealthy or deficit reduction plans that focus on numbers rather than people, I will continue to stand up for working families.

The five biggest oil and gas companies that are the focus of this hearing today will continue to post multi-million-dollar profits regardless of whether they continue getting billions of dollars in subsidies. I believe that we should allow these companies to stand on their own two feet and put taxpayer dollars to better use.

Securing comprehensive energy dependence means reducing unnecessary expenditures and decreasing our deficit. Many Americans continue to voice concerns about the burden our growing deficit could place on future generations. We must not go down the dangerous path of reducing our national deficit on the backs of hard-working American families, but should instead focus on the most effective and efficient ways to reduce the deficit, such as eliminating tax giveaways for big corporations that send American jobs overseas and asking big oil companies to step up and pay their fair share.

Statement of Senator Olympia J. Snowe
Finance Hearing: Oil and Gas Tax Incentives and Rising Energy Prices
Thursday, May 12, 2011

Thank you, Mr. Chairman, for holding this timely hearing to assess our current oil and natural gas tax incentives. Critically, our constituents, our small businesses, and our overall economy are struggling with gasoline prices as high as $4.17 per gallon and I want to thank our witnesses today for their insight into how our tax policies can be improved to provide Americans with affordable energy options.

According to the most recent data Americans spent $674 million on energy in March, accounting for 6.3 percent of all consumer expenditures – an increase of 28 percent over levels just two years ago. While this represents a challenge to every American household it also significantly burdens our aggregate economic growth. Specifically, according to Doug Porter, deputy chief economist at BMO Capital Markets, every $10 increase in the price per barrel oil translates to a reduction in US GDP growth by 20 basis points, or roughly $280 billion on an annualized basis. Critically, as we attempt to develop pro-growth strategies it is imperative that we acknowledge that the price of oil undermines job creation and reduces federal revenues. As a result, our energy policies should have a laser focus on providing our constituents with the ability to reduce their energy bills.

Yet, while our consumers struggle with these nearly record prices for this time of year, our federal tax policies have been on cruise control for years. Energy markets are dynamic and technology develops rapidly – Congress must demonstrate our capacity to end obsolete energy tax policies, and develop effective policies that will improve America's energy security. Current energy policies – from oil and gas subsidies, ethanol subsidies, and wind subsidies - were enacted years ago and are extremely costly to US taxpayers. Furthermore, the merits of their extension have not been demonstrated to the Senate Finance Committee. Irrespective of these facts last year we simply prolonged our existing tax policies without assessing the effectiveness, holding a mark-up, or even considering one amendment! Frankly, we must demonstrate more aggressive oversight and work diligently to update the tax code to reflect technology developments and the strain on the federal budget.

Clearly, with gasoline nearly at $4 per gallon, the American people deserve better. According to the most recent data from the Energy Information Administration, Mainers spend on average $1,667 every year on gasoline, yet we do not have rational tax policies that would assist individuals to purchase advanced vehicles that will save them money at the pump. Rather than providing tax credits for specific technologies, I have worked with Senators Bingaman, Lugar, Feinstein and Kerry on legislation, "The Efficient Vehicle Leadership Act," that would provide a tax credit correlated to the degree of efficiency – no matter whether it is an electric, natural gas, advanced diesel, or hybrid vehicle to provide maximum choice for Americans.

Furthermore, Mainers also spend the most on residential energy costs in the country. In fact, in 2008 when we experienced similar prices for heating oil EIA estimates that Mainers spent $3500 per household simply to keep the lights on and provide basic heat. Yet, while I led the effort to extend the 25C tax credits and allow consumers to continue to claim a 30 percent tax credit for the purchase insulation and energy efficient boilers, furnaces, and windows – the most cost-effective way to reduce energy bills – Congress simply let this critical policy to expire. As consumers attempt to prepare for high electricity costs for air conditioning for this summer, and individuals in cooler climates consider ways to address rising heating oil costs there are unfortunately limited tax policies to assist them to invest property that will reduce energy costs.

In contrast, this Committee has allowed the ethanol tax credit for oil refiners to continue at a cost of $5 billion, the wind grant for massive wind farms at a cost of $2.9 billion, as well as oil and gas subsidies. It is regrettable that costly and misguided policies have been maintained and it is my hope that we work at this Committee to review current policies, identify which are working and not working for our country and ultimately develop an energy policy that provides Americans with affordable energy in a fiscally responsible manner.

Accordingly, I hope this is the beginning of a critical discussion on this Committee and look forward to the testimony of our witnesses. I thank the Chair.

Rex W. Tillerson
Chairman and CEO, Exxon Mobil Corporation
United States Senate Committee on Finance Hearing
Washington, D.C.
May 12, 2011

Chairman Baucus, Ranking Member Hatch, members of the Committee. I appreciate the opportunity to address the topic of today's hearing, "Oil and Gas Tax Incentives and Rising Energy Prices."

All of us here today recognize the strain that high gasoline prices impose on many Americans, particularly during difficult economic times. And we owe it to our customers and your constituents to address the topic of energy prices and taxes in an open, honest and factual way.

Unfortunately, the tax changes under consideration that target the five U.S. energy companies represented here today fail to honor these goals.

It is not simply that they are misinformed and discriminatory. They are counterproductive. By undermining U.S. competitiveness, they would discourage future investment in energy projects in the United States and therefore undercut job creation and economic growth. And because they would hinder investment in new energy supplies, they do nothing to help reduce prices.

There is a more effective way to take steps to reduce prices and raise revenues – but, unfortunately, it is a way Congress and the Administration has so far rejected. If the U.S. oil and gas industry was permitted to develop our nation's enormous untapped energy supplies, it could put downward pressure on energy prices and increase revenues for government budgets.

Working together, industry and government can achieve our shared goals. In that spirit, I would like to offer several important facts on specific tax proposals that are currently being advocated by some in Washington.

First, it is important to make clear that tax provisions such as the Section 199 Domestic Production Activities deduction are not special incentives, preferences or subsidies for oil and gas, but rather standard deductions applied across all businesses in the United States.

Section 199 applies today to all U.S. domestic producers and manufacturers – from newspaper publishers, to corn farmers, to movie producers, and even coffee roasters. All can claim this deduction, which is intended to support job creation and retention in the United States.

By any reasonable definition it is not an oil and gas industry incentive. In fact, our industry is currently limited to only a 6 percent deduction, while all other U.S. manufacturers are allowed a 9 percent deduction.

Frankly, to then deny a select few companies within the oil and gas industry this standard deduction is tantamount to job discrimination. Why should an American refinery worker employed by a major U.S. oil and gas company in Billings, Montana be treated as inferior to an American movie producer in Hollywood, an American newspaper worker in New York, or an employee at a foreign-owned refinery in Lemont, Illinois?

Another tax measure that is misleadingly labeled a "subsidy" is the foreign tax credit provision, which upholds a basic tenet of tax fairness by preventing our overseas earnings from being double taxed.

This provision applies to all U.S. companies with overseas income, and has been in place since 1918. It is meant to protect U.S. competitiveness.

Again, U.S. oil and gas companies are already treated differently from other U.S. businesses under this provision, which includes unique and prescriptive rules on our industry requiring us to actually prove our foreign tax payments are indeed income taxes and not royalties.

If these rules were changed and the foreign income for select U.S. oil and gas companies like ExxonMobil were to be double taxed, our foreign-based competitors and the full range of foreign-government-owned oil companies would gain a significant competitive advantage.

Clearly, these tax provisions and others under consideration are not special industry incentives or subsidies; they are economy-wide, generally available deductions and credits under the tax code. Removing them for a select few U.S. oil and gas companies is therefore nothing less than a discriminatory and punitive tax hike, which jeopardizes the jobs of American workers.

Doing so would also do nothing to reduce the prices Americans pay at the pump. Gasoline prices are primarily a function of crude oil prices, which are set in the marketplace by global supply and demand – not by companies such as ours.

Furthermore, arbitrarily punishing five U.S. oil and gas companies by raising their taxes will generate far less government revenue than if we were allowed to compete and produce our nation's resources.

An August 2010 Wood Mackenzie study estimates that approximately $10 to $17 billion in direct upstream investment in this country is at risk per year if the Section 199 and other tax provisions are repealed for the industry.

Another recent Wood Mackenzie study found that opening up federal lands that Congress has kept off-limits for decades could generate 400,000 new jobs by the year 2025. And another analysis shows that such actions could generate as much as $1.7 trillion in government revenue over the life of the resource.

The fact is that raising taxes on five U.S. oil and gas companies is simply not the way to reduce prices or raise revenue. Increasing these companies' taxes would only discriminate against certain U.S. workers, make our companies less competitive against others who are in the same business, and discourage future energy investment.

A much better solution lies in permitting our industry to increase energy supplies – including supplies found here in North America, such as oil and natural gas found off our shores and in our shale formations.

Access – not taxes – will enable us to meet the goals of increasing affordable energy supplies for Americans, strengthening U.S. energy security, and powering our nation's economy forward. ExxonMobil shares these goals, and we look forward to working with you to achieve them. Thank you.

Senate Finance Committee Hearing
"Oil and Gas Tax Incentives and Rising Energy Prices"
May 19th, 2011
Questions for Mr. Rex Tillerson

From Senator Baucus

1. Exxon Mobil has a recent posting by Ken Cohen, V.P. of Public and Government Affairs on its "policy blog" titled "ExxonMobil's U.S. taxes and U.S. earnings—Some relevant numbers for Washington. Mr. Cohen states that ExxonMobil had total tax expense of $9.8 billion in 2010 which exceeded total U.S. operating earnings of $7.5 billion. Footnote 18 of ExxonMobil's the 2010 Form 10-K filed with the SEC provides a breakdown of the total $9.8 billion. It includes $6.2 billion in "sales-based taxes".

   I would like to ask each of you to describe the nature and amount of these U.S." sales based taxes" that you include as a tax expense in your financial statements. Are they federal excise taxes that are included in the price at the pump and effectively paid by consumers? Also, are these amounts included in your total sales reported on the income statement and therefore offset the amount reported as an expense?

   A: The majority of these taxes are federal excise taxes. Unlike sales taxes, federal excise taxes are not imposed on the consumer at the time of sale. They are imposed on the manufacturer at the time product is removed from a bonded area. The price at the pump is set by the market — there is no separate charge to the consumer.

   The important point is that the 2010 business activities of ExxonMobil in their broadest sense contributed almost $10 billion to federal, state, and local governments for use in providing overall public services. The actual economic burden or "incidence" of any tax is dependent upon a host of factors, most notably the elasticity of supply and demand. [1]

   If these taxes are effectively passed on to consumers, isn't describing them generally as taxes paid by your companies similar to a retailer claiming that they pay the state and local sales taxes that they collect from consumers and remit to the appropriate governmental authorities?

   A: As explained above, federal excise taxes are different than sales taxes. The blog post referenced above accurately reflects the federal excise taxes and all other sales based taxes as tax expense incurred by the company.

---

[1] For a more comprehensive review of the economic incidence of taxation issue, see Fullerton, Don & Metcalf, Gilbert E., 2002. "**Tax incidence**," Handbook of Public Economics, in: A. J. Auerbach & M. Feldstein (ed.), Handbook of Public Economics, edition 1, volume 4, chapter 26, pages 1787-1872 Elsevier. See also the informative Georgetown University powerpoint presentation on this topic at http://www9.georgetown.edu/faculty/aml6/econ001/pdfs/lec7.pdf.

2. According to ExxonMobil's 10-K for 2010, for every 1 dollar increase in the price of oil, ExxonMobil earns a 375 million after-tax profit.

   Last year, the average price of a barrel of oil was 72 dollars. The price of oil today is around 100 dollars and is projected to average over 100 dollars for the year.

   Doing simple math, if prices do average 100 dollars this year, ExxonMobil stands to earn in excess of 10 billion dollars in additional profit in 2011 than in 2010 just due to the increase in the price of oil.

   In contrast, the total amount of tax breaks under consideration today is approximately 2 billion dollars for all the companies at the table combined.

   I'd like to know from the other four companies how much in after-tax profit you earn from each 1 dollar increase in the price of oil.

   Wouldn't each of you agree that a price change of two or three dollars in a barrel of crude oil has a more meaningful impact on your investment decisions than your share of the effect of repealing all the tax provisions under consideration today?

   Isn't the value of a price of oil the most important driver for your business planning?

   A: No — we don't agree with your statement that a "price change of two or three dollars in a barrel of crude oil has a more meaningful impact" on our investment decisions than the effect of repealing "all the tax provisions under consideration." An initial point is that this question narrowly discusses price solely in the context of recent increases. As recently as 2009, however, crude oil prices decreased to around $30 per barrel. Our company's investment projects, however, span multiple decades and we bear both upside and downside price risks over the long-term. In contrast, we assume largely stable tax policies as a part of the economics of projects in which we actually invest; the potential of tax instability undermines investment.

   Moreover, developing and delivering energy involves multiple risks — safety and environmental risks, geopolitical risks, technical risks, and financial risks including price volatility. Our success is underpinned by our commitment to integrity — our systematic and unwavering focus on safety, operational excellence, financial discipline and high ethical standards.

   There are therefore multiple factors that we consider in our business planning, ranging from projections of global energy demand to the critical integrity we bring to individual projects around the world. Our multi-billion dollar capital projects are designed to operate over multiple decades, alongside ordinary fluctuations in commodity prices.

   Would you really consider producing less in the United States with the significant profits you earn with every additional barrel of oil produced?

   A: Sustaining and growing our production of oil and natural gas to meet growing global needs requires a dynamic investment discipline that allocates capital

toward the most promising and cost-effective supply prospects. An element of that capital allocation evaluation is the overall cost structure associated with each project, including taxes. Investment decisions are therefore made on an individual asset basis, and increasing taxes may cause certain projects to fail to meet our return criteria.

Crude oil and natural gas development is a global enterprise. As such, the alteration of regulatory or tax policies has the potential to divert investment capital toward or away from certain countries relative to other opportunities.

3. Some of the witnesses have testified that the oil and gas industry is already subject to high effective income tax rates. They refer to overall effective rates in excess of 40 percent. But these rates appear to be a weighted average of both U.S. and non-U.S. income tax rates applied to domestic and foreign earnings.

From financial reports filed with the SEC, it appears the effective U.S. income tax rates are significantly lower than the average foreign rates. It seems that the high foreign rates are pushing up the total reported effective rate. One of the companies stated in their financial disclosure that the weighted average statutory tax rate in countries in which they operate was 55.3 percent for 2010.

I would like to ask each of you what the U.S. tax rate is on just your U.S. income. And how does that compare to foreign tax rates you pay on your non-U.S. income?

A: ExxonMobil's federal and state effective U.S. income tax rate was 32% on average over the 2005–2010 period.

Our overall average effective tax rate outside the U.S. was 47% over the 2005–2010 period.

So isn't the U.S. actually a favorable income tax environment in which to engage in production, refining and distribution?

A: A favorable income tax environment includes a stable, predictable and non-discriminatory set of tax rules that creates a level playing field for all competitors. As explained below, some notable exceptions to those principles exist today, and the recurring proposals for further adverse changes continue to erode confidence for U.S. energy investors. Specifically, the "S. 940" provisions ["Close Big Oil Loopholes Act of 2011," proposed by Senator Menendez] would single out three to five taxpayers for unjust, punitive and arbitrary tax treatment. A tax environment that increases tax costs on an ExxonMobil refinery in Montana but not on a foreign-owned competitor in another state is hardly a favorable one. A tax environment that purposely double taxes three U.S. companies (ExxonMobil, Chevron, and ConocoPhillips) undercuts their ability to compete in the global market and can never be considered a favorable income tax environment.

While one would not know it from the incorrect descriptions used, current tax rules already single out integrated oil and gas companies for discriminatory tax treatment versus their competitors in the same business (e.g., the IDC

and G&G rules in the existing code). Within the broader energy industry, on a unit of energy produced basis, renewable and alternative energy producers receive enormous tax credits and cash grants that are not available to oil and gas producers. Further, all other domestic producers and manufacturers receive a 9% deduction under section 199, while the oil and gas companies are limited to a 6% deduction. That hardly seems a special preference to the oil and gas industry.

In the international arena, most of ExxonMobil's non-U.S. competitors are residents of countries that impose a territorial system of taxation on foreign income. The U.S., on the other hand, taxes its resident companies on their worldwide income. The negative impact of the worldwide system of taxation is mitigated by the availability of the foreign tax credit, but since Congress continues to make and propose changes to longstanding rules, this is hardly a "favorable tax environment". Proposals like the "dual capacity" changes in S. 940 would impose double taxation solely on three American-based oil and gas companies.

The United States is unusual in that its oil and gas resources under exploration, development, and production are widely dispersed, and generally smaller, more discrete resources, than those found in many countries. A rational economic environment that promotes the development of such resources can be expected to be different from foreign countries with more concentrated resources.

Finally, the quality of investment opportunity in any country is also a function of its regulatory structure. For example, the scale of development opportunities that result from specific leasing systems (or discretionary offerings) among countries competing to attract investment capital can be an extremely important factor. Variables include the geographical size of lease offerings and their location, their timeframes, their payment structures (e.g., bonuses, rentals, royalties), and development phases or benchmarks.

And wouldn't that still be the case, even if these subsidies did not exist?

A: We do not agree that the tax provisions that are under consideration in S. 940 are subsidies.

a. Section 199—Domestic Production Activities Deduction

The largest revenue item in S. 940 is the repeal of the domestic production activities deduction (found in section 199 of the Internal Revenue Code) — sometimes referred to as the domestic manufacturing deduction — for the five major integrated oil companies. We appreciate the opportunity to address the domestic manufacturing deduction because there have been so many mischaracterizations of this issue.

As background, The American Jobs Creation Act of 2004 provided new tax rules for **all** U.S. manufacturers and producers. While this legislation began as an effort to modify the Extraterritorial Income Exclusion (ETI) tax rules declared illegal by the World Trade Organization, Congress expanded that

goal to include the creation and retention of U.S. jobs throughout the critical domestic production and manufacturing sector, including, of course, jobs in the U.S. oil and natural gas industry.

Congress had not reduced the U.S. corporate income tax rate since 1986, despite rate cuts enacted by many other nations. Section 199 addressed this for U.S. manufacturers and producers since, as fully phased in, the deduction approximates a three percentage point reduction in the corporate income tax rate for all qualified domestic manufacturing and production income.[2] In the Emergency Economic Stabilization Act of 2008, the oil and gas industry was singled out for special adverse treatment by freezing the provision at the equivalent of the 2% rate reduction for that industry, while beginning in 2010, all other producers and manufacturers began receiving the 3% reduction.

The §199 provision applies to **all** qualified manufacturing activities in the U.S., i.e., it is not a provision designed solely for the oil and gas industry, or only for large companies in the oil and gas industry. Qualified activities include, among others, the production of computer software, electricity, water, sound recordings, and films, the manufacture of tangible personal property, and construction, architectural, and engineering services. Characterizing this general provision as an "oil company subsidy" or as a "tax break for big oil" is simply false. Repealing this provision only for five companies, while maintaining it for all other producers and manufacturers, would simply single out five companies within an industry for unjust, punitive and arbitrary treatment. That is highly discriminatory and unsound tax policy. And the result would be to discourage critical new oil and gas investments here in the U.S., by making those already costly domestic energy investments even more costly and thus less competitive with foreign opportunities.

Retaining §199 for all U.S. companies in the domestic oil and gas industry and keeping those investments on a par with all other domestic production and manufacturing activities will help increase domestic oil and gas investment and jobs, and reduce foreign import requirements.

b. The "Dual Capacity" Foreign Tax Credit Proposal

The second largest item in S. 940 is the proposal to modify the foreign tax credit rules applicable to major integrated companies which are dual capacity taxpayers. The United States subjects to taxation the "worldwide" income of its residents, including that of U.S.-based companies. To ensure that income earned outside the United States is not taxed twice, U.S. tax law permits a credit, or offset, against the taxes otherwise due on that income for foreign income taxes already paid. Without the foreign tax credit ("FTC"), U.S.-based companies would be unable to compete effectively with rivals from foreign countries with territorial tax systems (which exempt companies from tax on their foreign income) or with worldwide tax systems with properly-designed FTC mechanisms that prevent double taxation.

[2] The provision was "phased in" over several years, starting with the approximate equivalent of a 1% rate reduction for 2005 and 2006, a 2% rate reduction for 2007-2009, and finally the 3% reduction beginning in 2010.

S. 940 proposes to deny U.S. multinational companies FTCs for certain foreign taxes paid as "dual capacity taxpayers," thereby actually subjecting those companies to double taxation. A dual capacity taxpayer is a U.S. company that deals with a foreign country as both the sovereign and as the grantor of an economic benefit, such as a concession for developing the country's natural resources. To ensure dual capacity taxpayers cannot claim FTCs for payments that are not taxes, regulations in place for nearly 30 years require taxpayers to prove that no portion of a payment claimed as an income tax is for the separate economic benefit. In other words, current regulations effectively require oil and gas taxpayers to prove a negative, showing that no portion of a claimed income tax is a royalty, or a disguised royalty. If the taxpayer cannot make that showing, it loses. But, under S. 940, a major integrated oil company that could actually meet this extraordinary burden of proof would be denied access to the courts of the United States to do so, would be denied FTCs that its competitors received, and would by definition be subject to double taxation. This is punitive, capricious treatment that has no place in sound and fair tax policy; it is very much akin to a bill of attainder in that it singles out a small group for punishment without recourse to the courts.

Misleadingly characterizing the dual capacity taxpayer provision as a subsidy for oil companies is wrong. All industries are entitled to claim a foreign tax credit for income tax paid on foreign earnings. Oil companies are more sharply limited than all other industries in their ability to claim foreign tax credits, and thus far from receiving preferred treatment, they are subject to far greater restrictions than all others.

S. 940 would unfairly, and in effect retroactively and immediately, subject American companies to harmful double taxation on their existing long-term investments. The effect over the longer term will be to cede an important U.S. presence in strategic foreign markets to foreign and state-owned competitors, compromising U.S. economic, national security, and foreign policy interests.

c. Intangible Drilling and Development Costs

The final significant item in S. 940 is the provision to limit the deduction for intangible drilling and development costs for the major integrated oil companies. This provision is also often cited as a special "subsidy" for oil and gas producers when, again, there are parallels to expenditures in other industries that are actually more favorably treated. The majority of the so-called "intangible drilling costs" are in fact labor costs associated with the drilling of exploratory and development oil and gas wells. Moreover, the deduction for IDC simply relates to the timing of a deduction that is otherwise undisputed as a cost of doing business. Thus, there is no absolute tax benefit over time.

The drilling of wells is also akin to research and development costs incurred in other industries. In the oil and gas industry, discovering commercial quantities of oil or gas is not a certainty, and even if a well is successful, there is no certainty regarding the amount of the production over the life of the well.

A drug company researching and developing a new or replacement drug, or a high-tech company researching and developing a new software product, generally expenses those research and development costs in their entirety, and often additionally qualify for a research credit. The well drilling costs do not qualify for any research credit, and for integrated oil and gas companies, only 70% of such costs are deductible as incurred, with the remaining 30% being capitalized and recovered over a 5 year period. Again, one can "label" this as a special "subsidy" for oil and gas companies, but in fact it is quite similar to costs more favorably treated in other industries.

Maintaining the current treatment of intangible drilling and development costs for all U.S. companies in the domestic oil and gas industry will help increase domestic oil and gas investment and jobs, and reduce foreign import requirements. These provisions allow some portion of large costs associated with drilling to be recouped as incurred, with taxes paid when production volumes could be established. Repealing this provision only for five U.S. oil and natural gas producers and refiners is highly discriminatory and unsound tax policy.

4. Current tax rules arguably allow foreign tax credits for payments that are economically equivalent to royalties.

The proposal under consideration would limit creditable foreign taxes to generally applicable foreign taxes.

The three largest U.S. oil companies are on pace to earn 80 billion dollars in aggregate profit in 2011. Making the proposed changes to the foreign tax credit rules would cost your companies less than one percent of that profit.

Is it a serious problem for your company to pay less than 1% of your profits for the proposed modification?

A: This statement is a gross mis-characterization of current law. Current tax rules today do not "arguably" or otherwise permit foreign tax credits for payments that are economically equivalent to royalties. Just the opposite is the case. Regulations in place today impose a burden on U.S. oil companies to prove that foreign income tax payments are in fact not royalties. The proposal under consideration would take away a company's right to prove its entitlement to foreign tax credits for legitimate income tax payments, resulting in guaranteed double taxation. (Please refer to our response to question #3 above).

This proposal puts at risk the ability to effectively compete against non-U.S. companies in acquiring access to global reserves.

a. ***Cambridge Energy Research Associates Study***: A major study of changes in the competitive balance for access to critical oil and gas resources throughout the world, co-authored by Daniel Yergin and David Hobbs of Cambridge Energy Research Associates (CERA), revealed the following:

1. U.S.-based Investor-Owned Companies (or IOCs) were by far the largest international players in terms of production volume, acreage, and exploration activity at the start of the 1970s, but they have fared less well than the non-U.S.-based IOCs in recent decades. From a position of dominance, U.S.-based IOCs have been losing the race for access during the past three decades.

2. The competitive environment has changed dramatically with the widespread emergence of national oil companies in their home countries in the 1970s and the acceleration of competition from these companies as they began operating outside their home territories in the mid-1990s.

3. While the growth of National Oil Companies (NOCs) and International NOCs (INOCs) has been at the expense of IOCs as a class, the U.S.-based IOCs have been affected to a greater extent than those from Europe, Canada, Eurasia, and Asia.

4. Two factors emerged as most responsible for this difference: (a) the interaction between the fiscal arrangements in the home countries of the IOCs and the host countries in which they operate, and (b) home country policy objectives. The fiscal factors alone could account for differences in what a company can afford to bid for mineral rights, sometimes by as much as 100%.

5. U.S. companies have been losing out under current U.S. fiscal conditions, but proposals like the "dual capacity" changes will actually make matters worse still, putting American companies at a further and distinct competitive disadvantage to their major competitors studied, including those based in the UK, Netherlands, Russia, Canada, Norway, France, Italy, and China.

6. Why is this important? Here's what CERA says:

   "....home countries believe that it is worth winning the competition for access because the success of their oil companies brings benefits, including stable supply and greater confidence in energy security; direct (and indirect) employment by successful oil companies; promotion of home country services and equipment supply (e.g., steelwork, compressors, pumps etc.); securing research and development investment at home; the status of major oil companies as diplomatic flag bearers; and, not least, the repatriated dividends and taxes thereon that home countries expect to receive."

   But as CERA notes, these potential benefits can only be realized if home companies win the access race. Said differently:

   "The acquisition of mineral rights is the paramount point of competition between oil and gas companies irrespective of their origin. Win it, and a company will have the "fuel" in its portfolio to deliver

superior growth and returns. Lose it, and performance (and in the long term, survival) become an uphill struggle."

b. ***Wood Mackenzie Study***: The international consulting firm of Wood Mackenzie conducted a similar study of the impacts that the proposed changes to the dual capacity taxpayer rules would have on the ability of U.S.-based oil companies to obtain global oil and gas resources.

The Wood Mackenzie report notes the increased competition U.S.-based oil companies face from non-U.S. based companies, including INOCs. The report points specifically to the rise of the Asian INOCs, which have spent over $55 billion on international acquisitions over the 2009–2010 period, acquiring over 5 billion barrels of oil equivalent. The Chinese INOC, CNPC, now holds commercial interests in 17 countries outside of China.

In its report, Wood Mackenzie evaluates the economics of a typical upstream development in 14 countries. Access to reserves is typically awarded to the investor able to pay the most to the reserve owner or invest the most through exploration activity (assuming the operational, safety, geopolitical and technological risks are addressed satisfactorily). To determine how much to pay, an investor calculates the expected returns and the net present value of the proposed investment. The higher the net present value and expected returns, the more an investor is able to bid for the access rights. Taxes are costs that decrease the expected returns and net present value of the investment opportunity, and therefore, decrease the amount an investor is willing to pay.

If the dual capacity taxpayer proposal were enacted, the Wood Mackenzie analysis shows that non-U.S. based oil companies could outbid U.S.-based companies in all 14 countries examined. Some situations, such as Qatar, show that a non-U.S. based investor could offer twice as much as a U.S. investor for new reserves. The internal rate of return that a non-U.S. based investor could earn in a new project in Iraq is some five times higher than what a U.S.-based investor would be able to earn. The result is that U.S.-based oil and gas companies could not compete effectively against non-U.S. based investors for access to global oil and gas reserves. The report concludes:

> "Under the proposed changes to the dual capacity taxpayer rules, U.S. based oil and gas companies would face an additional or residual U.S. tax burden that they do not currently face. This additional U.S. tax will reduce the after-tax value and returns from overseas projects. This could make U.S. investors less able to acquire or develop overseas opportunities economically, compared to competitors who do not face a similar additional domestic tax burden."

As a result, non-U.S. based investors (and workers) would gain further competitive advantage over U.S.-based investors in the race to acquire new reserves and grow. This competitive advantage could result in a

reduction in global reserves available to U.S. investors because a non-U.S. investor would be able to earn a higher internal rate of return on these investments relative to U.S. investors. Non-U.S. investors could outbid U.S. investors for new reserves, whilst still generating adequate economic returns.

Furthermore, this proposal is likely to affect the value and rate of return of existing operations. Increased U.S. taxes on ongoing projects could force U.S.-based companies to consider selling these assets, as these projects may be more valuable to other investors. The higher value of the assets to other companies could result in the sale of overseas assets by U.S. investors to maximize shareholder value.[3]

5. In 2005, the then-CEO of your company testified before the Energy and Natural Resources Committee regarding energy prices and profits and stated that these tax breaks would have "zero effect" on ExxonMobil. Now, however, your company argues that eliminating these tax breaks will have a major impact on your company, the American people, and will cost thousands of jobs. Given that your first quarter profits were over $10 billion dollars, how can you argue that you need help from the government in order to do business?

A: This is not correct. You are mis-applying the answer given by Mr. Raymond (ExxonMobil's former Chairman and Chief Executive Officer) in a joint Senate Committee hearing in November 2005 to the specific tax increases proposed this year by Senator Baucus and those also proposed and voted down by the Senate on May 17 (the legislation proposed by Senator Menendez). The implication is wholly incorrect.

The discriminatory tax increases proposed this year relate to penalizing five companies within the oil and gas industry by depriving them of generally-available business deductions. In contrast, the reference to Mr. Raymond's statements in 2005 related to the need for incentives included in the Energy Policy Act of 2005 (EPACT), which were the explicit subject of the questions posed to industry CEOs. The November 9, 2005 hearing transcript makes that very clear in numerous respects, including:

> **Senator Wyden:** Is the President wrong when he says we do not need incentives *for oil and gas exploration*? If I could just have a yes or no answer, going right down the row beginning with you, Mr. Raymond.
>
> **Mr. Raymond**: No, I do not think our company has asked for any incentives for exploration....
>
> **Senator Wyden:** All right. Now, your companies have been charging record prices and getting record profits, but also getting record tax breaks.

[3] See also the paper submitted to U.S. Department of Treasury on July 21, 2010, entitled, **Economic and Foreign Policy Implications of the Administration's "Dual Capacity Taxpayer" Proposals (July 2010),** by Pamela F. Olson and Brian H. Jenn of Skadden, Arps, Slate, Meagher & Flom, LLP and Grant D. Aldonas Split Rock International, Inc.

Now, the President says they are not needed. You have just told me they are not needed. But Congress just a couple of months ago gave you several billion dollars in new tax breaks on top of the tax breaks you already get. My question to you is, why should not Congress take back the billions of dollars in brand-new tax breaks, breaks that you have just told me are not needed, and use that money to help people that are hurting in our country? Mr. Raymond, your response?

Mr. Raymond: I have heard that comment made many times since the passage of that legislation and I have asked my people many times if they could identify what so-called tax breaks are in that legislation that would apply to Exxon Mobil. The answer they come back with is, when you add it all up, that energy legislation is zero in terms of how it affects Exxon Mobil.

Senator Wyden: So you would have no problem, because I am on the Finance Committee and I am going to offer an amendment to take back the $2.6 billion of brand-new tax breaks and use that money to help people who are hurting. You said you are not getting any?

Mr. Raymond: As far as my company is concerned, it does not make any difference whether it is there or not.

...Senator Hutchison: Thank you, Mr. Chairman. Mr. Chairman, I was looking up some of the tax breaks that were mentioned earlier and trying to determine where those might be applied to oil companies. One is allowing natural gas distribution lines to be depreciated over 15 years instead of 20 to encourage more gas distribution lines. Another is an incentive for deep drilling in the Gulf, which we have had for a long period of time because of the risk and the cost that is added, and the Gulf being one of the few places that we can really drill on our shores. So my question is this. You say, well, we can do without the tax breaks, but when you are making the decisions about where you can put your money most productively do 15-year depreciation rules instead of 20-year depreciation rules, or incentives for something as expensive and risky as deep drilling in the Gulf, does it make a difference in where you start making allocation decisions as opposed to not needing it?

Mr. Raymond: Senator, I think the problem you get into here is that each company views that somewhat differently. I think in our own case when we look at the specific issues you talk about the conclusion we came to is that they will not significantly alter the programs that we have in any of those areas. That does not — but in saying that, that does not mean that is the case for every company.

In April 2006, ExxonMobil provided the following response to a related post-hearing question to Mr. Tillerson from **Senator Specter**:

3. Please provide an analysis of the incentives offered to petroleum companies by the federal government that explains what the

incentives are intended to do, which incentives are important to you, and why they should be maintained.

ExxonMobil Answer: Three tax provisions in the Energy Policy Act of 2005 would benefit ExxonMobil somewhat, although none of the three would be material. In fact, the three items are modest enough that when added together, they are less beneficial than the cost of another provision in the bill. The three positive tax items included in the 2005 Energy Policy Act are:

- Two year amortization of Geological and Geophysical ("G&G") expenditures, with a half-year convention.
- An election to expense 50% of refinery investments which increase the output capacity of an existing refinery by at least 5%, or which increase the throughput of qualified Section 29(c) fuels by at least 25%.
- A production tax credit, limited to four years, for coke and coke gas produced from facilities placed in service before 1/1/93 and between 6/30/98 and 1/1/10, up to an average BOE of 4,000 barrels per day, and effective for fuel produced and sold after 12/31/05. This provision was added during the conference and includes a credit phase-out tied to the price of crude (for example, in 2004, the phase-out would have begun with crude at $51.35, with full phase-out at a crude price of $64.46).

From ExxonMobil's standpoint, reinstatement of the Oil Spill Liability Trust Fund Tax, which is effective 4/1/06 and expires after 12/31/14, will cost us more per year than the three items above added together. In addition, the Leaking Underground Storage Tax ("LUST") was extended through 9/30/11, and expanded to include dyed fuel.

From Senator Baucus on Behalf of Senator Reid

1. How much did your company spend in 2010 in the U.S. on the research, development, demonstration or domestic production of clean, non-petroleum-based alternative transportation fuels? Please also identify the amount by which that estimated expenditure was effectively reduced through Federal tax deductions or tax credits, such as the research and development tax credit, claimed by the company.

   A: In 2010, ExxonMobil spent $67 million in the U.S. on research and development of non-petroleum-based alternative transportation fuels, primarily driven by the Algae Biofuels program.

   ExxonMobil's tax liability would reflect all allowable deductions and credits available for such expenditures. The amount qualifying for the Research and Experimentation (R&E) tax credit under section 41 of the Internal Revenue Code is expected to be considerably lower than this amount since the

definitions of R&D for SEC reporting are broader than the Internal Revenue Code definitions for R&E qualifying for the tax credit.

From Senator Wyden

1. You gave an interview on CNBC on March 9 where you said that the $20 run up in the price of oil in the previous few weeks was due to speculation. You referred to it as 'the market pricing in the risk premium." You went on to say that "all the markets are well- supplied with oil." As your interview made clear, there was clearly more at work in the market than just supply and demand.

   According to the Commodity Futures Trading Commission, more than 40% the trading in crude oil futures market is now done by folks who don't actually buy any oil, sell any oil, or use any oil. They are just in the market as a financial opportunity at the expense of people trying to get to work or plow their fields or drive their kids to school.

   When prices drop more than $8 dollars in a single day for no apparent reason, like they did last week, it's pretty obvious that something other than supply and demand is at work. Demand didn't suddenly go up 8% overnight. In fact, demand is down this year compared to the same time last year. Supply didn't suddenly drop overnight either. Inventories of oil in storage arc at or close to record levels.

   Given that the market price of oil has skyrocketed even at a time you said the markets were "well supplied with oil," wouldn't you agree that financial speculators have helped run up oil prices?

   A: Crude oil prices are influenced by a multitude of factors. These include physical and fundamental factors, such as supply, demand, inventory, and spare capacity, as well as expectations of the market participants on such matters as potential weather-related effects and outlooks on the growth of supply, demand, and capacity. In addition, crude oil prices can be affected by currency exchange rates, geopolitical risks, and actions of investors and financial institutions. It is not possible to identify definitively the impact of individual factors on crude prices.

   In general, more participants in a market bring broader and often competing perceptions and expectations leading to more efficient and transparent markets. When the expectations of market participants converge, this can lead to a significant run up, or down, in market prices. A high level of diverse participation limits the likelihood of this as well as the duration.

2. When arguing for opening up U.S. lands and waters for oil drilling, the oil industry complains that because most oil is controlled by foreign governments, the U.S. oil industry has no place else to go for access to oil and gas resources except in the U.S. But at today's hearing, you testified that if you lost the tax breaks you currently receive, more oil exploration and production would go offshore.

How can you claim both that you have no place else to go to drill for oil outside the U.S. and that if you lose tax breaks you'll move operations offshore? Isn't that a contradiction?

A: There is no contradiction, as ExxonMobil has not claimed that it is foreclosed from developing energy resources outside of the United States. In fact, the majority of our oil and natural gas production occurs outside of the United States. In 2010, over 80 percent of our crude oil production and over 75 percent of our natural gas production was outside of the United States.

Crude oil and natural gas development is a global enterprise. As such, the alteration of regulatory or tax policies has the potential to divert limited investment capital toward or away from certain countries relative to other opportunities.

3. During this morning's hearing, Mr. McKay responded that he agreed that it was appropriate to phase out the ethanol blending credit in light of the statutorily-mandated renewable standard requirement. Do you agree with Mr. McKay that it is time to phase out the ethanol blending credit?

A: ExxonMobil believes the ethanol tax credit is not needed to ensure demand today for domestic ethanol production or for meeting existing transportation fuel needs.

From Senator Thune

1. I want to discuss a particularly promising area of our country for domestic energy production, the Williston Basin located under parts of North Dakota, South Dakota, Montana and Canada. Some have called this area "Kuwait on the Prairie" because it holds the largest oil and gas find in North America since the Prudhoe Bay discovery in Alaska in the 1960s. Can you comment on the potential for job creation and economic development in the states I mentioned related to these oil and gas reserves. Would the tax increases in the President's budget and the legislation sponsored by Senator Menendez make you more or less likely to increase domestic production from these reserves, were these tax increases to be enacted into law?

A: Without question, development of the Williston Basin will significantly contribute to the nation's energy security by increasing domestic supply, and will also help fuel job creation and economic growth in the region. According to a 2008 assessment by the U.S. Geological Survey (USGS), an estimated 3 to 4.3 billion barrels of undiscovered, technically recoverable oil exists in the U.S. portion of the Williston Basin's Bakken Formation, "elevating it to a 'world-class' accumulation." The assessment also estimated mean undiscovered volumes of 1.85 trillion cubic feet of associated/dissolved natural gas and 148 million barrels of natural gas liquids. The Department of the Interior emphasized on May 19, 2011 that

> [t]he 2008 USGS assessment showed a 25-fold increase in the amount of technically recoverable oil as compared to the agency's 1995 estimate of 151 million barrels of oil. New geologic models applied to the Bakken

Formation, advances in drilling and production technologies, and additional oil discoveries resulted in these substantially larger technically recoverable oil volumes. About 135 million barrels of oil were produced from the Bakken between 1953 and 2008; 36 million barrels in 2008 alone.[4]

The conclusions of the 2008 assessment, requested by then-Senator Dorgan, demonstrate two important points about modern oil and natural gas production:

1. With continuously evolving innovation in the field of energy exploration, development, and production, the U.S. is finding that there are many more resources within its own borders that are available to increase domestic supply; and

2. New and emerging technologies are allowing U.S.-based energy companies to safely, securely and more efficiently produce those resources. What were once thought of as "unconventional" resources are rapidly becoming today's and tomorrow's reliable, "conventional" sources of North American energy supply.

- Oil and Gas Benefits to South Dakota

  In South Dakota, more than 18,000 jobs are supported by oil and gas development according to a 2009 study by PricewaterhouseCoopers (PwC). Those jobs earn combined total wages of about $709 million, and about $1.3 billion in economic benefits are created. Oil production in South Dakota has grown significantly since the first two wells began producing in 1954. According to the Energy Information Administration (EIA), 1.6 million barrels of crude oil were produced in 2010. Darren Johnson, a geologist with the South Dakota Department of Environment and Natural Resources, recently told the Williston Basin Conference that 28 oil and natural gas wells were drilled in South Dakota in 2010, that more would be drilled, and that production will increase in 2011.[5]

- Oil and Gas Benefits to North Dakota

  According to 2010 EIA data, about 112 million barrels of crude oil were produced in North Dakota. Thanks to the development of the Bakken shale within the Williston Basin, which has made it the fourth largest oil producer in the U.S., North Dakota has the lowest unemployment rate in the nation at 3.6 percent. According to the North Dakota Department of Commerce, the state added nearly 50,000 jobs — a 14.6 percent increase — between 2000 and 2010 due to Bakken activity. According to a May 2010 *Bismarck Tribune* article ("Looking ahead: Where will North

---

[4] U.S. Department of the Interior Press Release, "Bakken Formation Oil Assessment in North Dakota, Montana will be updated by U.S. Geological Survey," May 19, 2011 (http://www.doi.gov/news/pressreleases/Bakken-Formation-Oil-Assessment-in-North-Dakota-Montana-will-be-updated-by-US-Geological-Survey.cfm)

[5] Lucretia Cardenas, "Another recordbreaking year for Bakken Blend crude anticipated," *Platts Commodity News*, May 2, 2011

Dakota's money go?"), "revenue from oil extraction and production taxes will exceed $530 million [in 2010] and may reach $1 billion after next year."

- Oil and Gas Benefits to Montana

  According to the 2009 study by PwC, oil and gas development and production in Montana translates to about $4 billion in economic benefits — plus more than 40,000 jobs with combined total wages, salaries, and benefits of nearly $1.8 billion. In 2010, Montana produced 23.7 million barrels of crude oil, according to EIA data. Four refineries, including ExxonMobil's facility in Billings, provide employment for nearly 1,000 Montanans. According to an economic analysis conducted for the Montana Petroleum Association in 2007, these refineries produce nearly 30 million barrels of gasoline, 20 million barrels of diesel, and pay more than $52 million in state taxes.

- Oil and Gas Benefits to Native Americans

  Interior Secretary Ken Salazar has stated that "[t]he Bakken Formation is producing an ever-increasing amount of oil for domestic consumption while providing increasing royalty revenues to American Indian tribes and individual Indian mineral owners in North Dakota and Montana." According to the Department of the Interior, "agencies have been working closely, for example, with the Three Affiliated Tribes (the Mandan, Hidatsa and Arikara) and individual Indian mineral owners on the Ft. Berthold Reservation in North Dakota to facilitate this development."[6]

Enacting the punitive tax provisions within the President's budget or Senator Menendez's proposed legislation would make it less likely that the benefits of the Williston Basin resource can be realized. Higher taxes on domestic oil and gas producers will only limit their ability to invest in expanded domestic production, as well as in the new technologies that can even more efficiently produce this key American resource. For example, according to Dr. Scott Rickard of the Center for Applied Economic Research at Montana State University-Billings, "a change in how intangible drilling costs (IDCs) are treated could significantly reduce Montana oil drilling activity for up to five years after enactment, producing an $850 million reduction in economic activity in the oil sector."[7]

Finally, expeditious approval of the proposed Keystone XL pipeline by the State Department would help ensure that Williston Basin resources will have reliable access to U.S. refineries along the Gulf Coast. According to the State Department's Supplemental Draft Environmental Impact Statement on the Keystone XL project, "the Bakken Marketlink project would provide direct

---

[6] U.S. Department of the Interior Press Release, "Bakken Formation Oil Assessment in North Dakota, Montana will be updated by U.S. Geological Survey," May 19, 2011 (http://www.doi.gov/news/pressreleases/Bakken-Formation-Oil-Assessment-in-North-Dakota-Montana-will-be-updated-by-US-Geological-Survey.cfm)

[7] Montana Petroleum Association, *Montana Petroleum Association Briefing Book: Priority Issues in 2010*, p. 9 (http://www.montanapetroleum.org/assets/PDF/articlesReports/MPAIssueBriefs030810docx.pdf)

access to PADD II and PADD III markets," allowing the transport of up to 100,000 b/d of crude from the Williston Basin region in North Dakota and Montana to Cushing, Oklahoma and Gulf Coast refineries using the facilities of the proposed Keystone XL pipeline.[8]

From Senator Rockefeller

1. What was the average annual compensation for your company's top 5 executives over the past decade? Last year?

   A: The composition of our top five executives has changed appreciably over the last decade. However, enclosed are the relevant sections of our annual proxy statements for the past 10 years which contain the compensation for the top five executives in each year.

   Also enclosed is the relevant section of our 2011 proxy statement.

   The Summary Compensation Tables contained in the 2002 through 2011 Proxy Statements filed with the Securities and Exchange Commission (SEC) complied with SEC requirements at the time of submission. However, due to changes in disclosure requirements over the period referenced, meaningful data comparisons (on a like basis) across the period are not possible.

2. What is the single most important tax incentive your business receives? Why?

   A: We do not believe our business receives any significant special tax incentives. Please see our response to Senator Baucus' Questions 3 and 4 for an explanation of the tax provisions under consideration in S. 940 and how these provisions impact our business. In addition to the three items discussed in the responses to Senator Baucus' questions, S. 940 would repeal provisions for percentage depletion for oil and gas production and certain rules related to cost recovery of geological and geophysical (G&G) costs. The five companies targeted by S. 940 do not qualify for percentage depletion for oil and gas production nor the favorable G&G provisions.

3. Two of your highest dollar tax incentives are Dual Capacity and Intangible Drilling Costs. Which of these two provisions is more important to your company and which you would choose to live without if Congress is forced to choose between the two?

   A: Please see our response to Senator Baucus' Questions 3 and 4 for an explanation of these tax provisions and how they impact our business.

4. Some of you talk in your testimony of discriminatory treatment for your industry. It is my belief your industry has received preferred treatment for a century. Depletion goes back to 1916, and your industry was not eligible for the manufacturing

[8] U.S. Department of State, Supplemental Draft Environmental Impact Statement for the Keystone XL Project, April 22, 2011, p. 2-20

subsidies that the section 199 subsidy replaced. Yet your companies' lobbying efforts allowed you to benefit from 199 when enacted. How do you reconcile such special treatment with claims of discrimination?

A: We respectfully disagree. Please see our responses to Senator Baucus' Questions 3 and 4 for an explanation of the major tax provisions under consideration in S. 940 and how our industry has been targeted for discriminatory treatment relative to other taxpayers. To be clear, percentage depletion was repealed for our company and the other major integrated oil and gas companies in 1975.

From Senator Roberts

1. Understanding that the five companies appearing before us today are all publicly traded, and are about 98% owned by individuals or institutional investors who are managing pension funds, mutual funds and IRAs for millions of middle class Americans that rely on these holdings for their economic security and retirement; what impact do your companies' record profits this past year have on middle class Americans whose economic portfolios invest in U.S. integrated oil companies?

A: ExxonMobil is a large, publicly traded integrated oil company. Our shares are held by both retail and institutional shareholders. Retail or individual investors hold approximately 50 percent of our outstanding shares. The remaining approximately 50 percent is held by institutional investors, who manage mutual funds, pension plans and retirement accounts. Through direct or indirect shareholdings, many, many Americans invest in ExxonMobil.

A recent study by Sonecon, commissioned by the American Petroleum Institute, found that oil and natural gas company holdings in state pension funds are providing disproportionately strong returns for retirees. While oil and natural gas stocks make up an average of 3.9 percent of public pension holdings in the four key states of Pennsylvania, Ohio, Missouri and Michigan, they accounted for an average of 8.6 percent of the returns in these accounts from 2005 to 2008. The study is enclosed.

In addition, according to an earlier Sonecon study, more than 29 percent of oil and natural gas company shares are held in mutual funds; 27 percent are held in pension funds; 23 percent are owned by individual investors; 14 percent are held in IRAs. Five percent are held by institutions and only 1.5 percent of industry shares are owned by corporate management.

2. How significant of a role does certainty in tax policy play for your companies when making investments decisions regarding greater domestic production and, more importantly, when hiring new employees?

A: Tax policy certainty plays a very significant role for our company when making domestic investment decisions. Investments in oil and gas exploration and development projects require a long term commitment of massive amounts of capital. As we all have seen, the oil and gas business is

a highly cyclical one, and the fact that prices are high at the current time is no guarantee that they will stay that way throughout the 20–30 years of the project life; history certainly tells us that.

Sufficient capital exists to invest in domestic projects within our company, within our industry, and within the capital markets that oil and gas companies may access. But the question is whether the investor has a reasonable prospect, taking into account the huge uncertainties associated with such investments, to realize an acceptable return over the project life for undertaking such risks. Adverse changes to tax laws not only reduce the value of investments made in reliance on those rules, after the fact, but inject even more uncertainties and risks for future projects. And increasing taxes on U.S. oil and gas investments will result in less domestic investment, and ironically, even greater reliance on foreign imports.

According to a recent study by PricewaterhouseCoopers, the oil and natural gas industry supports more than 9.2 million jobs throughout the U.S. economy. These are high-paying jobs for middle-class Americans. Several studies conducted by the international consulting firm of Wood Mackenzie over the past few years conclude that higher taxes on the industry lead to reduced investment, job losses and increased reliance on imports.

From Senator Snowe

1. With prices as high as $100 the question today is whether our energy tax policies are effectively creating incentives to change behavior — rather than simply making cost- effective business decisions only more profitable.
As a result, I find it interesting that in an analysis last year of the implications of removing these tax incentives that the American Petroleum Institute included an assumption that oil is at $80 per barrel. The analysis, done by Wood and Mackenzie, concluded that removing these tax incentives would alter the "breakeven" point for oil — that is the cost for profitability — from an average of $47.00 per barrel to $52.00 per barrel — or 10 percent.

   In addition, the report's executive summary concludes that under scenarios where oil is higher than $80 the removal of oil and gas subsidies would not affect oil production at all. While I recognize that additional subsidies lead to additional production, it would seem that there would be decreasing returns from more and more subsidies for U.S. oil production.

   Specifically, while the report states concerns about the effects on natural gas production with the removal of subsidies the report states, "The impact to the oil market is much lower, as less than 60,000 barrels are at risk under the proposed changes in 2011." Effectively, the report concludes that if oil is priced at points higher than $80 per barrel the removal of these incentives will not result in any lost oil production.

   At a time when oil is priced at roughly $100 — and if these prices were to continue — do you agree with the API report that there would not be any reduced production of oil in the United States if the tax incentives were removed?

A: First, we do not agree with the characterization of the provisions under consideration in S. 940 as "subsidies or incentives". Please see our responses to your following question and to Senator Baucus' Questions #3 and 4 for a fuller explanation of these provisions.

Increasing taxes on domestic production will not promote production in the United States, even when the current price of oil is roughly $100 per barrel. Investments in oil and gas exploration and development projects require a long term commitment of massive amounts of capital. As we all have seen, the oil and gas business is a highly cyclical one, and the fact that prices are high at the current time is no guarantee that they will stay that way throughout the 20–30 years of the project life.

Sufficient capital exists to invest in domestic projects within our company, within our industry, and within the capital markets that oil and gas companies may access. But the question is whether the investor has a reasonable prospect, taking into account the huge uncertainties associated with such investments, to realize an acceptable return over the project life for undertaking such risks. Adverse changes to tax laws not only reduce the value of investments made in reliance on those rules, after the fact, but inject even more uncertainties and risks for future projects. Increasing taxes on U.S. oil and gas investments will result in less domestic investment, less domestic production, and ironically, even greater reliance on foreign imports.

Do you support removing these tax subsidies for oil at a certain point, perhaps the long- term level that EIA or your companies predict that oil will be in 5-10 years?

A: As noted, we do not agree with the characterization of the provisions under consideration in S. 940 as "subsidies or incentives". Section 199, available to all domestic producers and manufacturers (at an even greater rate than for oil and gas producers and manufacturers) is a provision of general application and hardly a special subsidy for the oil and gas industry. Singling out five companies in the oil and gas industry for exclusion from the production and manufacturing deduction is not eliminating a subsidy — it is punitively taxing just 5 oil and gas companies at a higher rate than any other domestic producer or manufacture. How do we explain to our employees that their jobs are somehow not as valuable to the nation as auto or steel workers or Hollywood film producers?

The foreign tax credit provisions, including the specific rules applicable to oil and gas companies (the so-called dual capacity rules) are required under our worldwide income taxation system to prevent double taxation. They are not described as subsidies, or even as tax expenditures, by the Joint Committee on Taxation or any other official governmental body. See in particular the JCT explanation of this provision in the Explanation to the Obama Administration's budget for 2011 (published by the JCT in August of 2011).

Intangible drilling costs are likewise not anything special for the oil and gas industry, but are similar to costs of other industries that receive equal, or more favorable, treatment.

Please also see our responses to Senator Baucus' Questions #3 and 4 for a further explanation of these provisions.

2. We have witnessed the continued volatility of our energy futures markets, with for instance gasoline prices falling 7.6 percent on May 11th, 2011, coming during a year when gasoline has increased by more than 28 percent. The development yesterday came when the U.S. Department of Energy surprised traders by reporting an unexpected buildup of gasoline stockpiles in the previous week.
This situation yesterday raises two critical questions regarding the efficiency of our energy markets. First, as the Commodity Futures Trading Commission is considering now, should we adopt position limits for particular traders to reduce the volatility of specific contracts. As a leader, along with Senators Feinstein and Cantwell, on developing a strong derivative title within the financial reform bill, I strongly believe transparency and restrictions on specific trades will not restrict price discovery, but will reduce volatility and potential for manipulation.

Secondly, trading on May 11th again demonstrates how critical it is for an efficient market to have access to accurate and timely data. This is not like any other market — information regarding consumption, production, and reserves are controlled, in some instances, by America's adversaries.

For instance, just last month the Wall Street Journal reported that "unreliable data on production, starting with the world's largest exporter, are adding to the price volatility..." and that the "revelation highlighted a problem that is roiling markets at the moment: a dearth of solid information about the true state of production and supplies."

As a result of these developments do you believe that the CFTC should adopt strict position limits for speculative traders and do you believe that there is enough transparency in these markets to accurately assess efficient pricing of oil?

A: ExxonMobil does not take speculative positions in the market. Each of the existing commodity exchanges has both position limits and margin call rules which are updated as the exchanges deem appropriate in response to changes in market conditions.

Given the level and diversity of participation in the oil market and the ample evidence of the response of the market to many factors that influence oil price, it is reasonable to conclude that the oil market is one of the more efficient and transparent markets in the world. Market liquidity is important for ensuring rapid dissemination of market information. Unreasonable barriers to trade or participation could impede normal trading signals and reduce efficiency and transparency.

Do you believe that current prices are reflective of supply and demand?

A: Crude oil prices are influenced by a multitude of factors. These include physical and fundamental factors, such as supply, demand, inventory, and spare capacity, as well as expectations of the market participants on such matters as potential weather-related effects and outlooks on the growth of supply, demand, and capacity. In addition, crude oil prices can be affected by currency exchange rates, geopolitical risks, and actions of investors and financial institutions. It is not possible to identify definitively the impact of individual factors on crude prices.

In general, more participants in a market bring broader and often competing perceptions and expectations leading to more efficient and transparent markets. When the expectations of market participants converge, this can lead to a significant run up, or down, in market prices. A high level of diverse participation limits the likelihood of this as well the duration.

Do you believe that foreign countries are doing enough to supply the world with information about reserves and production and what can the United State government do to facilitate information sharing?

A: As a major participant in the global energy market, we are continuously working to understand near- and longer-term energy supply and demand needs, particularly as they may affect our operations and investment plans. Accordingly, we seek to acquire sound knowledge of supplies, resources, market developments and trends based on information available from a wide variety of sources. Helpful sources include a wide variety of energy reporting and consulting companies as well as governmental agencies such as the U.S. Energy Information Administration (EIA) and the International Energy Agency (IEA) that help capture information or estimates about energy supplies (including reserves and potential resources) and demand trends for many key regions and countries around the world.

Since the IEA was formed following the 1973–74 oil crisis, its role has continued to evolve and expand such that today it is uniquely positioned as a leading authoritative source of information on energy markets and challenges ahead. At the same time, it is increasingly engaged in helping facilitate a global dialogue on energy. In recent years, it has worked to establish greater ties with key countries affecting global supplies and demand in order to facilitate a better understanding among key regions and nations about energy markets today and in the future. By participating and helping facilitate these discussions, the United States government can play a positive role in improving the global understanding about available energy resources as well as supply and demand trends. In addition, close consultation of the U.S. EIA with similar organizations in other regions and nations is likely to help improve understanding of reserves and resource potential and boost energy literacy. The EIA's report *World Shale Gas Resources* is a recent example in this regard.

While there remains considerable focus on sources of energy supplies, it is also worth noting that demand trends are continuing to evolve and are likely to contribute to a significant reshaping of energy requirements around the world over the coming decades. The recent economic recession and slow recovery have been important factors in the supply/demand balance around the world. Today and in the future, understanding the scope and nature of these changing demand patterns remains fundamental to having a sound knowledge of U.S. and global energy markets.

We also expect the United States government will continue to benefit by ensuring it solicits a wide variety of views regarding the energy future. In this regard, ExxonMobil has been working for many years to boost energy literacy by sharing our annual *Outlook for Energy – A View to 2030* report with policymakers, opinion leaders and the general public around the world. This report provides a comprehensive assessment of global and regional energy trends and challenges, and serves as a strategic foundation for our own investment planning.

3. The Tax Reform Act of 1986 is constantly referred to as a model for tax reform and the point often made any new reform we undertake should follow its lead, which was to broaden the base and to reduce tax rates. The phrase "broaden the base" is just a clever way of saying "eliminate tax provisions" such as credits and deductions that clutter the code in order to simplify the code and to provide the revenue needed to offset the corresponding reduction in tax rates.

The Democrats have presented us with an opportunity to broaden the base by eliminating certain tax provisions, namely, the tax benefits that are available currently to the five companies before us today. But instead of lowering the rates, the plan is to use the revenue from these cuts to pay down the deficit —just another way avoiding the spending cuts that the American people recognize has led us to these deficits.
The Finance Committee has held a series of tax reform hearings and I thank Chairman Baucus for that. One thing we have learned is that the tax code is filled with too many special provisions and today we are debating yet one more complication to a tax code that is screaming for simplification.

What we should be pursuing is a comprehensive energy plan at the same time we pursue comprehensive tax reform. There is wide agreement that the rates are too high for our American companies to remain competitive — even the Obama Administration has suggested cutting corporate tax rates. We could start to do so today, with a down- payment made on such rate reductions by the elimination of the oil and gas provisions currently on the table.

We have to ensure the competitiveness of American companies and cutting the tax rate is one goal where we already have some consensus. We just need to agree on how to get there. Do you agree that reducing tax rates would justify the elimination of the oil and gas tax provisions we are discussing today? Do you think that rather than stop with these oil and gas provisions, we should also eliminate other energy subsidies in order to provide the broadest possible rate reductions?

A: Please see our responses to Senator Baucus' Questions #3 and 4 for a description of the three major tax provisions under consideration in S. 940. Two of those three provisions — the section 199 deduction and expensing of intangible drilling costs — apply to domestic production only. With respect to these provisions, we support comprehensive tax reform that looks at all provisions of the tax code, is neutral across industries, promotes growth, and brings the rates down as low as possible. With respect to the tax treatment of energy sources, we do not believe that Congress should single out one type of energy from others for substantially different tax treatment. We need all forms of domestic energy production and our tax code should be as neutral and even handed as possible. We would support the elimination of tax credits that relate solely to oil and gas, such as the enhanced oil recovery and marginal well credits, provided that similar items for other energy sources are also eliminated. This is what neutrality requires — i.e., if energy specific incentives are to be eliminated for some, they should be eliminated for all.

Unbiased tax provisions that apply irrespective of the type or scope of business should not be mis-characterized as energy specific "tax subsidies." There are several items frequently mis-identified as special "subsidies for oil and gas companies" which are not in fact unique to the industry (such as the section 199 provisions and the treatment of intangible drilling and development costs). We do take exception to eliminating these provisions unless they, or their analogous provisions, are eliminated for all companies and all industries.

The third major proposal in S. 940 — the dual capacity taxpayer provision — would result in double taxation of foreign earned income, and therefore, has no place in a discussion of comprehensive tax reform that is designed to "ensure the competitiveness of American companies." It would have exactly the opposite effect.

4. As you are aware, the United States has significantly increased its proven reserves of natural gas through innovative methods of extraction. Some estimates suggest that at current consumption rates, U.S. reserves could supply our country for 100 years. Clearly, there is a major economic opportunity with these resources.

   This raises some fundamental questions if our current consumption of natural gas is cost-effective and whether additional policies should be implemented to either expand our domestic consumption or develop infrastructure to sell natural gas at higher prices internationally. For instance, some Members have suggested increasing consumption of natural gas in our transportation system and some companies have expressed interest in exporting natural gas through liquefied natural gas (LNG) terminals.

   While I recognize that the free market would shift demand towards low-cost and stable supplies, which natural gas enjoys today, does ExxonMobil support tax incentives to accelerate these developments?

A: The safe and effective development of our nation's vast unconventional natural gas resources is important for economic prosperity, our energy security, and our environmental progress.

As EPA Administrator Lisa Jackson stated in May 24, 2011, testimony before the House Government Oversight and Reform Committee:

> This Administration is also committed to promoting timely and safe domestic natural gas development. Thanks to advances in drilling technology, including hydraulic fracturing, America's potential natural gas resource is nearly fifty percent larger than we believed it was just a few years ago.* The price we pay for natural gas is not set on a global market the way the price of oil is, and burning natural gas creates less air pollution than burning other fossil fuels. So, if done safely, increasing America's extraction of natural gas can have a number of economic benefits.

The enormous potential of natural gas in this country has become clear in recent years as a combination of long-standing practices (such as horizontal drilling and hydraulic fracturing) and new technologies have unlocked vast supplies of unconventional gas in the United States. About 100 years of U.S. natural gas supply at current U.S. consumption rates is now available, which nearly doubles projections from just a few years ago.

Producing these resources has clear economic and environmental benefits for Americans. Natural gas emits up to 60 percent less carbon-dioxide than coal when used to produce electricity. And in 2008 alone, the natural gas industry contributed $385 billion to our nation's economy.

Although energy demand in the near term was impacted by the global recession, over the long-term global energy demand will continue to rise. ExxonMobil expects demand will grow approximately 35 percent from 2005 levels by the year 2030 — even with substantial gains in efficiency. It is important to note that most of the world's new energy demand will actually come from the developing world, where economic prosperity will continue to grow and where citizens will be achieving new, heightened standards of living. To meet this growing demand we need to pursue all commercially viable energy sources.

In this regard, we expect demand for natural gas to surpass demand for coal as it becomes a favored fuel for power generation. Power generation is the sector where natural gas can make the most immediate and significant impact. Growing demand for electricity has been the trend for the last 30 years, and will continue as living standards improve. Increasing natural gas use in power generation presents the most cost-effective and large-scale option currently available to reduce greenhouse gas emissions.

In addition to being a low-cost option, gas-fired power generation has other distinguishing characteristics. It requires lower unit capital investment,

---

* http://www.eia.doe.gov/energy_in_brief/about_shale_gas.cfm

shorter construction time, and better response to changes in electrical load, which helps maintain power system stability.

In order to realize these benefits, consistent, balanced policies must be in place. On the demand side, energy policies should ensure a level playing field for all fuel types, including natural gas. When policymakers begin to pick specific energy sources, technologies, companies or regions as winners or losers — in terms of direct subsidies, mandates or unsound fiscal or regulatory processes that unfairly favor or burden certain options — the final outcomes generally cause higher consumer energy prices and economic harm. Our energy future will be most sustainable over the long-term when it is built on an unbiased market driven foundation.

Does ExxonMobil have any plans to export natural gas from the United States?

A: ExxonMobil does not currently export or re-export LNG from North America, although we continually evaluate opportunities based on a range of economic conditions.

From Senator Enzi

You all indicated that you were in favor of overall corporate tax reform. In that regard, I have three questions:

1. If Congress were to take up corporate income tax reform and eliminate provisions of the tax code that benefit traditional and alternative energy industries, to what rate would the corporate income tax need to be lowered to avoid a net tax increase on your company?

   A: Please see our response to Senator Snowe's question above regarding tax reform. While we have no specific view on the correct rate or which provisions should be eliminated or altered, we welcome the debate on comprehensive tax reform. We do endorse the general principles of tax reform recently issued by the U.S. Chamber of Commerce, as follows:

   - Tax reform legislation should lower the corporate tax rate to a level that will enable U.S. businesses to compete successfully in the global economy, attract foreign investment to the United States, increase capital for investment, and drive job creation in the United States. Congress should adjust individual tax rates so that the corporate rate reduction will not negatively impact pass-through entities.

   - In addition to reducing tax rates, tax reform should eliminate the bias in the current U.S. tax system against capital investment. Capital investment should be expensed or recovered using a capital cost recovery system that provides the present value equivalent to expensing with due regard to the impact the system may have on cash flow.

- In the international arena, the current worldwide tax system should be replaced with a territorial system for the taxation of foreign source income to enable U.S. businesses to compete successfully in the global economy, as well as domestically against foreign firms, and to promote economic growth domestically.

- Changes should be permanent to ensure certainty for businesses striving to expand, create jobs, and remain competitive in the United States and abroad.

- Fundamental reform should take place in the near-term, and Congress should not, in the interim, adversely change the current tax policy.

- Congress preferably should pass comprehensive tax reform legislation; conversely, Congress should avoid undertaking tax reform on a piecemeal basis.

- In considering tax reform legislation, Congress should give equal attention to government spending to strike a reasonable balance with a tax code that fosters economic growth, job creation, and investment.

- Congress should enact simple, predictable and easy to understand tax rules to improve compliance and reduce the cost of tax administration.

- Tax reform legislation should ensure that no specific industry, sector or income group disproportionately bears the burden of paying for tax reform. Tax reform should result in a tax code that allows the marketplace, not the tax system, to allocate capital and resources.

- Comprehensive tax reform should include realistic transition rules to provide adequate time for implementation and help minimize economic hardships businesses may encounter in transitioning to the new tax system.

2. While I support the ideas of individual and corporate tax reform, I am concerned that a dramatic change in our tax code will be problematic for companies and individuals who have done long term tax planning. Do you agree with my assessment that there needs to be a phase in period? If so, how long should that phase in period be? If not, please explain how your company would handle such a change in the tax code.

   A: We agree that realistic transition rules and an adequate phase in period for fundamental changes are important elements of comprehensive tax reform. See also our response to the previous question.

3. Are there any provisions of the tax code that you would prefer not be changed if we were to lower the corporate tax rate as a part of overall corporate tax reform?

   A: We are open to changes that conform to the principles set forth in the response to Senator Enzi's first question above.

From Senator Cantwell

1. The discussion of tax subsidies and incentives in the May 12, 2011 Finance Committee hearing was largely an abstract one on the overall economic and societal costs and benefits that result from these measures. I would appreciate having more specific information on the extent to which your firms have benefited from the tax provisions being discussed over the last decade. For your respective firms, would you please provide auditable data on your company's utilization of each of the following categories and for each of the past ten years (2000-2010):
   - Enhanced Oil Recovery Credit
   - Credit for Oil and Gas from Marginal Wells
   - Expensing of Intangible Drilling Costs
   - Deduction for Tertiary Injectants
   - Passive Loss Exception for Working Interests in Oil Properties
   - Percentage Depletion for Oil and Natural Gas Wells
   - Domestic Manufacturing Deduction for Oil and Natural Gas Companies
   - Geological and Geophysical Amortization
   - Net annual profit

   A: Several items listed in this question do not apply to major integrated oil and gas companies or were not available in any meaningful amount to ExxonMobil over the 2000–2010 period. These include the credit for oil and gas from marginal wells (none claimed), passive loss exception for working interests in oil properties (not applicable), percentage depletion for oil and gas production (not applicable), and the geological and geophysical amortization rules providing for amortization over a 2 year period (not claimed or inapplicable). Other items are simply the timing of a deduction that is otherwise undisputed as a cost of doing business, such as the expensing of intangible drilling and development costs and the deduction for tertiary injectants and thus for which there is no absolute tax benefit over time.

   The remaining items, i.e., the enhanced oil recovery credit and the deduction attributable to domestic production activities (under Section 199 of the Internal Revenue Code) were available for some or all of the years. The former phased out after 2005 and the latter only began in 2005 and was phased in over several years.

   While we are unable to provide specific data on these provisions, (and the 2010 federal income tax return effects are estimated), we can say that although they certainly have an impact on whether specific projects meet adequate return standards to justify a particular investment, over the 2000–2010 period, these two provisions reduced overall U.S. tax expense reported

in our Form 10-K financial reports by the equivalent of a rate reduction of less than 1.2 percent.

Based on our 10-K financial reporting, total U.S. income tax expense over the 2000–2010 period was $36 billion and total U.S. income before income taxes was $109 billion.

You have asked for information on ExxonMobil's net annual profits for the years 2000–2010. We have enclosed ExxonMobil's Form 10K for these years for your reference.

ExxonMobil supports efforts to simplify and reform the tax rules in the U.S. to provide a reliable, predictable framework for taxation that is administered in a fair way to provide a level playing field for all. We believe that tax reform should allow U.S. businesses to compete successfully in the global economy, attract foreign investment to the U.S., increase capital for investment, and drive job creation in the United States. ExxonMobil would welcome the opportunity to work with Congress to achieve this goal.

2. I think we can all agree that America's future prosperity and competitiveness is contingent on figuring out how we can live within our means while providing our businesses more predictability and stability in the marketplace, in part by providing a more level playing field for all market participants. I would argue that one thing we can do is to ensure that U.S. industries all receive equal treatment under the federal tax code so that they operate on an equal footing. I don't understand, for example, why oil companies should be allowed to write off the costs of machinery and other so-called "intangible costs" immediately, while companies in other industries have to write off these expenses gradually, over the lifetime of the equipment they purchase. Likewise, a few years ago, Congress to redefine the word "manufacturing" so that oil companies could take advantage of a manufacturing tax deduction for oil production.

   I was intrigued by an argument that Mr. Watson made in his testimony, which if I understood him correctly, argued that we should not change tax breaks for the oil industry outside of a broader context of corporate tax reform.

   Does that mean that you might all be willing to work with Congress to figure out ways to simplify and reform our nation's byzantine tax code in the interest of replacing the myriad of tax expenditures we are discussing here today with lower overall corporate tax rates for all industries?

   A: ExxonMobil is in agreement with the view "that U.S. industries [should] all receive equal treatment under the federal tax code so that they operate on an equal footing." To achieve this goal as it relates to Intangible Drilling Costs ("IDC"), all taxpayers incurring IDC should be allowed to deduct those costs as incurred. However, the rule allowing recovery of IDC for integrated oil companies is different than the rule for non-integrated companies. Integrated oil and gas companies must recover 30% of their IDC over five years, while non-integrated oil and gas companies expense the entire amount of IDC in the year incurred. There have been numerous court cases on determining what is and is not IDC. Assuming a cost meets the criteria for being

classified as IDC, that cost does not result in an asset with a salvage value beyond the time of the expenditure.

Further, one must look outside the oil and gas industry for analogous types of expenditures to test for "equal footing." IDC, in general, are largely the labor costs of drilling and developing wells for the production of oil and gas. They are the oil and gas industry's equivalent of research and development costs. R&D of other industries, like software, drug, or other new product research and development, is deductible as incurred (with some even qualifying for a special tax credit).

Another provision where oil and gas companies are not afforded equal treatment in order to have equal footing is the deduction for production and manufacturing income under IRC §199. In 2004, to encourage job creation, Congress enacted a "Domestic Production Activities" tax deduction. As enacted, it applies to all domestic production, manufacturing, extraction, and farming activities. The definition of qualified production activity income has been stretched to include computer software design, architectural services, filmmaking, and even newspaper income. Domestic oil and gas production and refining activities were included since they clearly meet the definition and the goals of the legislation. This deduction is equal to 9% of qualifying income for everyone except the oil and gas industry. In 2008, Congress limited this deduction for oil and gas production and refining income to 6% of qualifying income, creating another example of the oil and gas industry not receiving equal treatment under the federal tax code.

3. Considering all the uncertainties that affect your industry and the United States as a whole, would you support efforts to create a policy framework which provides greater certainty and stability when it comes to energy prices, regulation, and supply and demand fundamentals? I believe that is an important question because eventually Congress will regulate greenhouse gas emissions. This moment may come as soon as next year if the DC Circuit throws out EPA's tailoring rule. Would your companies support be supportive of legislation that established a price on carbon in a manner that was transparent, market-based, technology and fuel neutral, and economy-wide, as an alternative to EPA regulation of greenhouse gases?

A: There is widespread agreement that the Clean Air act was never designed to, and is an unsuitable way to, regulate greenhouse gas emissions. ExxonMobil would support a carbon price mechanism that is transparent, market-based, technology and fuel neutral and economy-wide, and which recognizes the potential impacts on trade exposed businesses. We support a policy framework that provides certainty and stability to encourage investment. The best approach will be one that:

- Ensures a uniform and predictable cost of carbon across the economy;
- Maximizes transparency to companies and consumers;
- Reduces administrative complexity;
- Better promotes global participation; and
- Is more easily adjusted to future developments in climate science and the economic impacts of climate policies.

ExxonMobil believes a revenue neutral carbon tax best accommodates these key criteria.

4. A spokesman for Exxon Mobil was quoted last year in the Climate Wire (February 24, 2010) as saying that, "discussions of alternative, more transparent and sustainable approaches to climate change policy are positive," and went on to say that Exxon favors the inclusion of a price collar for any carbon pricing mechanism. Do these statements still reflect ExxonMobil's views on climate change legislation?

   A: ExxonMobil continues to believe that a revenue-neutral carbon tax is a more efficient and more transparent way to reflect the cost of carbon in all economic decisions than the various so-called "cap and trade" schemes that have been proposed. A carbon tax can be implemented through the existing tax infrastructure and avoids the complexity of building a new market for carbon securities. We believe this is preferable to any cap and trade system, with or without a price collar.

5. Both the Joint Economic Committee and the Congressional Research Service produced analyses that show that removing tax expenditures to the oil industry as proposed in S. 940 will lead to significant gasoline price increases or oil production decreases. Do you agree with conclusions of these reports? And if not, please describe in detail the flaw or flaws in their analyses. Are there any independent studies that demonstrate that eliminating these tax expenditures will significantly increase prices or reduce domestic oil and gas production?

   A: ExxonMobil did not state in the hearing that it would be raising gas prices at the pump if the tax provisions being discussed are repealed. ExxonMobil does not project future prices of gas at the pump, nor do we comment on our internal projections of oil and gas prices and the factors that go into the analysis. ExxonMobil is not aware of any independent studies that demonstrate that eliminating these tax provisions will significantly increase prices or reduce domestic oil and gas production. This statement is not meant to say that such studies do not exist.

From Senator Menendez

1. According to the Energy Information Administration, the average cost to produce a barrel of oil is around $33; but SEC filings show that the average production costs for the Big 5 are much lower, at about $11. With a barrel of oil selling for around $100, why do you need subsidies? Can each of you tell the Committee and the American people what price per barrel and profit margin you will need to reach before these subsidies are no longer necessary?

   A: We do not agree that the tax provisions in S. 940 are subsidies. Please see our responses to the questions of Senator Baucus on the impact on U.S. oil and gas investments if taxes are increased on domestic oil and gas as proposed and the effect on American companies and American jobs if the foreign tax credit proposals of S. 940 were enacted.

Further, we do not believe that it is ever appropriate tax policy to single out 3 to 5 taxpayers in the entire country for specific, punitive tax treatment as S. 940 does.

Also, as point of clarification, the average production costs which you reference that are shown in SEC filings do not reflect the entire cost to produce a barrel of oil (or gas equivalent). Not reflected in these SEC-defined production costs are exploration costs, investments in infrastructure to enable production (i.e., depreciation), taxes and transportation costs.

2. Please provide a detailed accounting of how many dollars your company did not pay in taxes as a result of the tax subsidies proposed to be eliminated in S.940, the Close Big Oil Tax Loopholes Act, for each of the last 5 years.

A: We do not agree that the tax provisions in S. 940 targeted for repeal for just 3–5 companies are tax subsidies. On the impact of the tax provisions, please see our responses to Senators Baucus and Cantwell above.

3. In your testimony you said that last year, after paying your bills and making all of the future investments you deemed worthy, "what's left over" is $19 billion. You testified that "if we don't need it" this money is used to pay dividends and repurchase your company's own stock. Tell me, why are you unwilling to give up tax breaks that amount to $500 million per year when you have $19 billion that you "don't need?"

A: We do not agree that the tax provisions in S. 940 are subsidies. Please see our responses to the questions of Senator Baucus on the impact on U.S. oil and gas investments if taxes are increased on domestic oil and gas as proposed and the effect on American companies and American jobs if the foreign tax credit proposals of S. 940 were enacted.

Further, we do not believe that it is ever appropriate tax policy to single out 3 to 5 taxpayers in the entire country for specific, punitive tax treatment as S. 940 does.

After we have paid our bills and funded future investments that will deliver acceptable returns regardless of business cycle, whatever remains we return to our shareholders in the form of dividends or share purchases. The cashflow generated is mainly the result of earnings, after taxes, from our global business. It is through disciplined investments and strong operational performance that we are able to generate strong earnings and cash generation. What remains after paying our bills, including taxes, and funding our investment program is distributed back to the shareholders (via dividends and share purchases).

Selected pages from the ExxonMobil proxy statement, regarding

2010
Executive Compensation

Table of Contents

EXECUTIVE COMPENSATION TABLES

Summary Compensation Table for 2010

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
R.W. Tillerson	2010	2,207,000	3,360,000	15,465,375	0	0	7,476,262	443,921	28,952,558
Chairman and CEO	2009	2,057,000	2,400,000	16,963,875	0	0	5,466,517	280,925	27,168,317
	2008	1,870,000	4,000,000	17,604,000	0	0	8,290,253	446,826	32,211,079
D.D. Humphreys	2010	1,085,000	2,144,000	7,904,525	0	0	2,305,873	124,445	13,563,843
PFO; Senior Vice President	2009	1,010,000	1,418,000	8,022,028	0	0	1,296,163	124,403	11,870,594
	2008	910,000	2,364,000	8,324,736	0	0	4,599,191	108,989	16,306,916
M.J. Dolan	2010	920,000	1,592,000	5,773,740	0	0	3,173,100	98,597	11,557,437
Senior Vice President	2009	845,000	1,046,997	5,805,415	0	0	1,902,652	94,733	9,694,797
H.R. Cramer	2010	911,250	1,500,000	5,292,595	0	0	1,377,443	102,957	9,184,245
Vice President;	2009	682,500	1,046,997	5,805,415	0	0	2,537,500	90,219	10,362,631
President, ExxonMobil Fuels Marketing Company	2008	843,333	1,744,598	6,024,480	0	0	3,215,127	87,522	11,915,060
S.D. Pryor	2010	955,000	1,500,000	5,292,595	0	0	952,086	106,927	8,806,608
Vice President; President,	2009	940,000	1,046,997	5,805,415	0	0	2,644,266	119,858	10,556,536
ExxonMobil Chemical Company	2008	905,000	1,744,598	6,024,480	0	0	3,571,656	311,614	12,557,348

Leadership Structure

- The disclosure regulations result in a roster of Named Executive Officers different from the most senior management team leading the Company, which is referred to as the Management Committee. The Management Committee comprises the following:
  - Chairman and CEO: R.W. Tillerson
  - Senior Vice Presidents who report directly to the CEO:
    - D.D. Humphreys;
    - M.W. Albers;
    - M.J. Dolan; and,
    - A.P. Swiger.
- All members of the Management Committee are shown as Named Executive Officers except for Messrs. Albers and Swiger. Consistent with our career orientation, which is supported by a career-based compensation strategy, their individual compensation levels do not currently place them among the Named Executive Officers.
- Although each member of the Management Committee is responsible for specific business activities, together they share responsibility for the performance of the Company.

Employment Arrangements

ExxonMobil's Compensation Committee believes senior executives should be "at will" employees of the Corporation. Accordingly, the CEO and other executive officers, including the other officers named in these tables, ***do not have employment contracts, severance agreements, or change-in-control arrangements*** with the Company.

Table of Contents

Salary

- Effective January 1, 2011, the annual salary of the Named Executive Officers increased as follows: Mr. Tillerson's to $2,387,000, Mr. Humphreys' to $1,170,000, and Mr. Pryor's to $972,000. Effective April 1, 2011, the annual salary for Mr. Dolan increased to $1,010,000.
- The 2010 and 2011 salary increases reflect adjustments to the competitive position of the base salary program for U.S. executives, taking into account individual experience and level of responsibility.
- Salary (together with other compensation related to fringe benefits or perquisites) is not deductible by the Corporation to the extent that it exceeds $1 million for any Named Executive Officer.

Bonus

- As described in more detail in the CD&A, the 2010 bonus shown was paid half in cash at the time of grant. The Company delays payment of the balance until cumulative earnings reach $5.75 per share.
- Delayed bonus amounts do not earn interest.
- The bonus and the stock awards described below are intended to meet the requirements of Section 162(m) of the Internal Revenue Code. See "Tax Matters" on page 40.

Stock Awards

- In accordance with disclosure regulations, the valuation of "Stock Awards" in this table represents the grant date fair value, which is equal to the number of shares awarded times the grant price, which is deemed to be the average of the high and low sale prices on the NYSE on the grant date ($68.74 on November 23, 2010; $75.40 on November 24, 2009; and $78.24 on November 25, 2008).
- See the narrative accompanying the "Grants of Plan-Based Awards" table for information regarding the terms of restricted stock.
- Dividends on stock awards are not shown in the table because those amounts are reflected in the grant date fair value.

Change in Pension Value and Nonqualified Deferred Compensation Earnings

The amounts shown in this column in the "Summary Compensation Table" represent the change in pension value. Earnings on nonqualified deferred compensation are not required to be included since as of January 1, 2008, interest is limited to 120 percent of the long-term Applicable Federal Rate.

Pension Value

- The change in pension value shown in the table for 2010 is the increase between year-end 2009 and year-end 2010 in the present value of each executive's pension benefits under the plans described in more detail in the text following the "Pension Benefits" table on page 49.
- For each year end, the data reflect an annuity beginning at age 60 (or current age if over 60) equal to 1.6 percent of the participant's covered compensation multiplied by years of service at year end. These values are converted to lump sums using the plan's applicable factors and then discounted. For employees under age 60, this discount is calculated to present values based on the time difference between the individual's age at year-end 2010 and age 60 (and at year-end 2009 and age 60) using the interest rates for financial reporting of pension obligations as of each year end. The difference between the two year-end amounts represents the annual increase in the value of the pension shown in the "Summary Compensation Table."
- The lump sum interest rate applied for an employee who worked through the end of 2009 was 4 percent. The lump sum interest rate applied for an employee who worked through the end of 2010 was 3.75 percent.

Table of Contents

- The discount rate for determining the present value of benefits was 6 percent as of year-end 2009 and 5.5 percent as of year-end 2010.
- The reductions in the lump sum interest rate and the discount rate are contributing factors in the increase in the present value of age 60 benefits shown.

All Other Compensation

The following table breaks down the amounts included in the "All Other Compensation" column of the "Summary Compensation Table" in 2010.

Name	Life Insurance ($)	Savings Plan ($)	Personal Security ($)	Personal Use of Company			Financial Planning ($)	Total ($)
				Aircraft ($)	Properties ($)	Car ($)		
R.W. Tillerson	45,294	154,490	204,378	29,409	900	0	9,450	443,921
D.D. Humphreys	34,175	75,950	3,860	0	971	39	9,450	124,445
M.J. Dolan	18,886	64,400	5,119	0	681	61	9,450	98,597
H.R. Cramer	28,829	63,787	876	0	0	15	9,450	102,957
S.D. Pryor	30,215	66,850	533	0	0	929	8,400	106,927

Life Insurance

- The Company offers senior executives term life insurance or a Company-paid death benefit.
- Coverage under either option equals 4 times base salary until age 65, and a declining multiple thereafter until age 75, at which point the multiple remains at 2.5 times salary.
- For executives with life insurance coverage, the premium cost in any year depends on overall financial and mortality experience under the group policy.
- For executives electing the death benefit, there is no cash cost until the executive dies, as benefits are paid directly by the Company.
- The amount shown is based on Internal Revenue Service tables used to value the term cost of such coverage. This valuation is applied since the actual life insurance premium is a single payment for a large group of executives that does not represent the cost of insuring one specific individual, and because one of the Named Executive Officers has elected the death benefit, the long-term cost of which is comparable to the insurance.
- The Company eliminated the executive term life insurance and Company-paid death benefit for all newly eligible executives as of October 1, 2007, and retained it for all current participants, including the Named Executive Officers.

Savings Plan

- The amount shown is the value of Company-matching contributions under ExxonMobil's tax-qualified defined contribution (401(k)) plan and Company credits under the related nonqualified supplemental plan. The Company credit was previously 6 percent of salary and was increased to 7 percent effective January 1, 2008, which is consistent with the matching contribution for all employees participating in the savings plan.
- The nonqualified supplemental plan provides all affected employees with the 7-percent Company credit to which they would otherwise be entitled as a matching contribution under the qualified plan but for limitations under the Internal Revenue Code. All affected employees participate in the nonqualified supplemental plan on the same basis.
- The value of the credits to the nonqualified supplemental plan is also disclosed in the "Nonqualified Deferred Compensation" table on page 51.

Table of Contents

Personal Security

- The Company provides security for its employees as appropriate based on an assessment of risk. The assessment includes consideration of the employee's position and work location.
- The Company does not consider any such security costs to be personal benefits since these costs arise from the nature of the employee's employment by the Company; however, the disclosure regulations require certain security costs to be reported as personal benefits.
- The amounts shown in the table include the following types of security-related costs: security systems at executive residences; security services and personnel (at residences and/or during personal travel); car and personal security driver; and Company mobile phones. Costs of security relating to travel for business purposes are not included.
- Cars provided for security reasons and used primarily for commuting are valued based on the annualized cost of the car plus maintenance and fuel. Reported costs for rental cars utilized due to security concerns during personal travel are the actual incremental costs.
- For security personnel employed by the Company, the cost is the actual incremental cost of expenses incurred by the security personnel. Total salary, wages, and benefits for security personnel are not allocated because the Company already incurs these costs for business purposes.
- For security contractors, the cost is the actual incremental cost of such contractors associated with the executive's personal time.
- For Mr. Tillerson, the amount shown includes $28,634 for car and $167,708 for residential security. The remainder is for mobile phones and other communications equipment for conducting business in a secure manner, and the cost of security relating to personal travel.

Aircraft

- Incremental cost for personal use of the aircraft is based on direct operating costs (fuel, airport fees, incremental pilot costs, etc.) and does not include capital costs of the aircraft since the Company already incurs these capital costs for business purposes.
- For security reasons, the Board requires the Chairman and CEO to use Company aircraft for both business and personal travel.
- The Committee considers these costs to be necessary, security-related business expenses rather than perquisites, but per the disclosure regulations, we report the incremental cost of aircraft usage for personal travel.

Properties

- The Company owns or leases various venues for the purpose of business entertainment, including boxes and season tickets to sporting events and recreation and conference retreat properties. When these venues are not otherwise in use for business entertainment, the tickets and properties may be available for use by Company executives and other personnel.
- The table shows the incremental cost incurred for any personal use of these venues by the Named Executive Officers.
- Cost for this purpose is based solely on incremental operating costs (catering, transportation, incremental employee or contractor costs, etc.) and does not include annual or capital costs of these venues since the Company already incurs these costs for business purposes.

Car

- Incremental cost for personal use of company car by executives other than Mr. Tillerson (whose car-related expenses are included under "Personal Security") is based on an assumed cost in 2010

Table of Contents

of $0.50 per mile. Driver personnel costs are not allocated because the Company already incurs these costs for business purposes.

Financial Planning

- The Company provides financial planning services to senior executives, which includes tax preparation. This benefit is valued based on the actual charge for the services.

Grants of Plan-Based Awards for 2010

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Under-lying Options (#)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards ($)
		Thresh-old ($)	Tar-get ($)	Maxi-mum ($)	Thresh-old (#)	Tar-get (#)	Maxi-mum (#)				
R.W. Tillerson	11/23/2010	0	0	0	0	0	0	225,000	0	0	15,465,375
D.D. Humphreys	11/23/2010	0	0	0	0	0	0	115,000	0	0	7,904,525
M.J. Dolan	11/23/2010	0	0	0	0	0	0	84,000	0	0	5,773,740
H.R. Cramer	11/23/2010	0	0	0	0	0	0	77,000	0	0	5,292,595
S.D. Pryor	11/23/2010	0	0	0	0	0	0	77,000	0	0	5,292,595

The awards granted in 2010 are in the form of restricted stock.

Restrictions and Forfeiture Risk

- These grants are restricted: (1) for half the shares, until five years after the grant date; and, (2) for the balance, until 10 years after the grant date or retirement, whichever occurs later. These restricted periods are not subject to acceleration, except upon death, and thus, shares may remain subject to restriction for many years after an executive's retirement.
- During the restricted period, the executive receives the same cash dividends as a holder of regular common stock and may vote the shares; however, the executive may not sell or transfer the shares, or use them as collateral.
- The shares also remain subject to forfeiture during the restricted period in case of an unapproved early termination of employment or in case the executive is found to have engaged in activity that is detrimental to the Company. Detrimental activity may include conduct that violates the Company's Ethics or Conflicts of Interest policies.

Grant Date

- The grant date is the same as the date on which the Compensation Committee of the Board met to approve the awards, as described beginning on page 40.
- Grant date fair value is equal to the number of shares awarded times the grant price, which is deemed to be the average of the high and low sale prices on the NYSE on the grant date (November 23, 2010; $68.74).

Selected pages from the ExxonMobil proxy statement, regarding

2009
Executive Compensation

Table of Contents

EXECUTIVE COMPENSATION TABLES

Summary Compensation Table for 2009

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
R.W. Tillerson *Chairman and CEO*	2009	2,057,000	2,400,000	16,963,875	0	0	5,466,517	280,925	27,168,317
	2008	1,870,000	4,000,000	17,604,000	0	0	8,290,253	446,826	32,211,079
	2007	1,750,000	3,360,000	16,120,900	0	0	5,511,588	429,792	27,172,280
D.D. Humphreys *PFO; Senior Vice President*	2009	1,010,000	1,418,000	8,022,028	0	0	1,296,163	124,403	11,870,594
	2008	910,000	2,364,000	8,324,736	0	0	4,599,191	108,989	16,306,916
	2007	830,000	1,859,000	7,912,312	0	0	3,919,806	86,689	14,607,807
M.J. Dolan *Senior Vice President*	2009	845,000	1,046,997	5,805,415	0	0	1,902,652	94,733	9,694,797
H.R. Cramer *Vice President;* *President, ExxonMobil Fuels Marketing Company*	2009	882,500	1,046,997	5,805,415	0	0	2,537,500	90,219	10,362,631
	2008	843,333	1,744,598	6,024,480	0	0	3,215,127	87,522	11,915,060
	2007	807,917	1,586,000	6,709,780	0	0	2,294,584	86,202	11,484,483
S.D. Pryor *Vice President; President, ExxonMobil Chemical Company*	2009	940,000	1,046,997	5,805,415	0	0	2,644,266	119,858	10,556,536
	2008	905,000	1,744,598	6,024,480	0	0	3,571,656	311,614	12,557,348

Leadership Structure

- The disclosure regulations result in a roster of Named Executive Officers different from the most senior management team leading the Company, which is referred to as the Management Committee. The Management Committee comprises the following:
  - Chairman and CEO: R.W. Tillerson
  - Senior Vice Presidents who report directly to the CEO:
    - D.D. Humphreys;
    - M.W. Albers;
    - M.J. Dolan; and,
    - A.P. Swiger.
- All members of the Management Committee are shown as Named Executive Officers except for Messrs. Albers and Swiger. Consistent with our career orientation, which is supported by a career-based compensation strategy, their individual compensation levels do not currently place them among the Named Executive Officers.
- Although each member of the Management Committee is responsible for specific business activities, together they share responsibility for the performance of the Company.

Employment Arrangements

ExxonMobil's Compensation Committee believes senior executives should be "at will" employees of the Corporation. Accordingly, the CEO and other executive officers, including the other officers named in these tables, ***do not have employment contracts, severance agreements, or change-in-control arrangements*** with the Company.

Salary

- Effective January 1, 2010, the annual salary of the Named Executive Officers increased as follows: Mr. Tillerson's to $2,207,000, Mr. Humphreys' to $1,085,000, and Mr. Pryor's to $955,000. Effective April 1, 2010, the annual salary for Mr. Dolan increased to $935,000.
- The 2009 and 2010 salary increases reflect adjustments to the competitive position of the base salary program for U.S. executives, taking into account individual experience and level of responsibility.
- Salary (together with other compensation related to fringe benefits or perquisites) is not deductible by the Corporation to the extent that it exceeds $1 million for any Named Executive Officer.

Bonus

- As described in more detail in the "Compensation Discussion and Analysis" (CD&A), the 2009 bonus shown was paid half in cash at the time of grant. The Company delays payment of the balance until cumulative earnings reach $5.75 per share.
- Delayed bonus amounts do not earn interest.
- The bonus and the stock awards described below are intended to meet the requirements of Section 162(m) of the Internal Revenue Code. See "Tax Matters" on page 38.

Stock Awards

- In accordance with disclosure regulations, the valuation of "Stock Awards" in this table represents the grant date fair value which is equal to the number of shares awarded times the grant price, which is deemed to be the average of the high and low sale prices on the NYSE on the grant date ($75.40 on November 24, 2009; $78.24 on November 25, 2008; and $87.14 on November 28, 2007).
- See the narrative accompanying the "Grants of Plan-Based Awards" table for information regarding the terms of restricted stock.
- Dividends on stock awards are not shown in the table because those amounts are reflected in the grant date fair value.

Change in Pension Value and Nonqualified Deferred Compensation Earnings

The amounts shown in this column in the "Summary Compensation Table" for years 2009 and 2008 represent the change in pension value. For year 2007, the amount also includes nonqualified deferred earnings for Messrs. Tillerson, Humphreys, and Cramer.

Pension Value

- The change in pension value shown in the table for 2009 is the increase between year-end 2008 and year-end 2009 in the present value of each executive's pension benefits under the plans described in more detail in the text following the "Pension Benefits" table on page 47.
- For each year end, the data reflect an annuity beginning at age 60 (or current age if over 60) equal to 1.6 percent of the participant's covered compensation multiplied by year-end service. These values are converted to lump sums using the plan's applicable factors and then discounted in the case of employees under age 60 to present values based on the time difference between the individual's age at year-end 2008 and age 60 (and at year-end 2009 and age 60) using the interest rates for financial reporting of pension obligations as of each year end. The difference between the two year-end amounts represents the annual increase in the value of the pension shown in the "Summary Compensation Table."
- The lump sum interest rate applied for an employee who worked through the end of 2008 was 4.25 percent. The lump sum interest rate applied for an employee who worked through the end of 2009 was 4 percent.

Table of Contents

- The discount rate for determining the present value of benefits was 6.25 percent as of year-end 2008 and 6 percent as of year-end 2009. The reduction in the lump sum interest rate and the discount rate results in an increase in the present value of age 60 benefits shown for the Named Executive Officers.

Nonqualified Deferred Earnings

- The portion of annual earnings on each executive's principal balance under the Corporation's nonqualified supplemental savings plan that exceeds 120 percent of the long-term Applicable Federal Rate, compounded monthly, as prescribed under Section 1274(d) of the Internal Revenue Code, is required to be disclosed. As of January 1, 2008, the basis for the interest rate during the term of a participant's employment was changed from the Citibank prime lending rate to 120 percent of the long-term Applicable Federal Rate. As a result, reportable earnings on nonqualified deferred compensation have not been incurred since 2007.

All Other Compensation

The following table breaks down the amounts included in the "All Other Compensation" column of the "Summary Compensation Table." Note the table has been changed from last year as follows: removed the columns "Relocation" and "Tax Assistance" since the Named Executive Officers did not have any relocation costs or receive any tax assistance in 2009.

Name	Life Insurance ($)	Savings Plan ($)	Personal Security ($)	Personal Use of Company			Financial Planning ($)	Total ($)
				Aircraft ($)	Properties ($)	Car ($)		
R.W. Tillerson	42,135	143,990	63,550	21,222	578	0	9,450	280,925
D.D. Humphreys	31,733	70,700	3,201	6,441	2,872	6	9,450	124,403
M.J. Dolan	17,234	59,150	7,971	0	903	25	9,450	94,733
H.R. Cramer	18,163	61,775	831	0	0	0	9,450	90,219
S.D. Pryor	29,687	65,800	14,801	0	0	1,170	8,400	119,858

Life Insurance

- The Company offers senior executives term life insurance or a Company-paid death benefit.
- Coverage under either option equals four times base salary until age 65, and a declining multiple thereafter until age 75, at which point the multiple remains at 2.5 times salary.
- For executives with life insurance coverage, the premium cost in any year depends on overall financial and mortality experience under the group policy.
- For executives electing the death benefit, there is no cash cost until the executive dies, as benefits are paid directly by the Company.
- The amount shown is based on Internal Revenue Service tables used to value the term cost of such coverage. This valuation is applied since the actual life insurance premium is a single payment for a large group of executives that does not represent the cost of insuring one specific individual and because several of the Named Executive Officers have elected the death benefit, the long-term cost of which is comparable to the insurance.
- The Company eliminated the executive term life insurance and Company-paid death benefit for all newly eligible executives as of October 1, 2007, and retained it for all current participants, including the Named Executive Officers.

Table of Contents

Savings Plan

- The amount shown is the value of Company-matching contributions under ExxonMobil's tax-qualified defined contribution (401(k)) plan and Company credits under the related nonqualified supplemental plan. The Company credit was previously 6 percent and was increased to 7 percent effective January 1, 2008.
- The nonqualified supplemental plan provides all affected employees with the 7-percent Company credit to which they would otherwise be entitled as a matching contribution under the qualified plan but for limitations under the Internal Revenue Code. All affected employees participate in the nonqualified supplemental plan on the same basis.
- The value of the credits to the nonqualified supplemental plan is also disclosed in the "Nonqualified Deferred Compensation" table on page 49.

Personal Security

- The Company provides security for its employees as appropriate based on an assessment of risk. The assessment includes consideration of the employee's position and work location.
- The Company does not consider any such security costs to be personal benefits since these costs arise from the nature of the employee's employment by the Company; however, the disclosure regulations require certain security costs to be reported as personal benefits.
- The amounts shown in the table include the following types of security-related costs: security systems at executive residences; security services and personnel (at residences and/or during personal travel); car and personal security driver; and Company mobile phones. Costs of security relating to travel for business purposes are not included.
- Cars provided for security reasons and used primarily for commuting are valued based on the annualized cost of the car plus maintenance and fuel. Reported costs for rental cars utilized due to security concerns during personal travel are the actual incremental costs.
- For security personnel employed by the Company, the cost is the actual incremental cost of expenses incurred by the security personnel. Total salary, wages, and benefits for security personnel are not allocated because the Company already incurs these costs for business purposes.
- For security contractors, the cost is the actual incremental cost of such contractors associated with the executive's personal time.
- For Mr. Tillerson, the amount shown includes $27,440 for car and $30,822 for residential security. The remainder is for mobile phones and other communications equipment for conducting business in a secure manner, and cost of security relating to personal travel.

Aircraft

- Incremental cost for personal use of the aircraft is based on direct operating costs (fuel, airport fees, incremental pilot costs, etc.) and does not include capital costs of the aircraft since the Company already incurs these capital costs for business purposes.
- For security reasons, the Board requires the Chairman and CEO to use Company aircraft for both business and personal travel.
- The Committee considers these costs to be necessary, security-related business expenses rather than perquisites, but per the disclosure regulations, we report the incremental cost of aircraft usage for personal travel.

Properties

- The Company owns or leases various venues for the purpose of business entertainment, including boxes and season tickets to sporting events and recreation and conference retreat properties. When

Table of Contents

these venues are not otherwise in use for business entertainment, the tickets and properties may be available for use by Company executives and other personnel.

- The table shows the incremental cost incurred for any personal use of these venues by the Named Executive Officers.
- Cost for this purpose is based solely on incremental operating costs (catering, transportation, incremental employee or contractor costs, etc.) and does not include annual or capital costs of these venues since the Company already incurs these costs for business purposes.

Car

- Incremental cost for personal use of company car by executives other than Mr. Tillerson (whose car-related expenses are included under "Personal Security") is based on an assumed cost in 2009 of $0.55 per mile. Driver personnel costs are not allocated because the Company already incurs these costs for business purposes.

Financial Planning

- The Company provides financial planning services to senior executives, which includes tax preparation. This benefit is valued based on the actual charge for the services.

Grants of Plan-Based Awards for 2009

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Under-lying Options (#)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards ($)
		Thresh-old ($)	Tar-get ($)	Maxi-mum ($)	Thresh-old (#)	Tar-get (#)	Maxi-mum (#)				
R.W. Tillerson	11/24/2009	0	0	0	0	0	0	225,000	0	0	16,963,875
D.D. Humphreys	11/24/2009	0	0	0	0	0	0	106,400	0	0	8,022,028
M.J. Dolan	11/24/2009	0	0	0	0	0	0	77,000	0	0	5,805,415
H.R. Cramer	11/24/2009	0	0	0	0	0	0	77,000	0	0	5,805,415
S.D. Pryor	11/24/2009	0	0	0	0	0	0	77,000	0	0	5,805,415

The awards granted in 2009 are in the form of restricted stock.

Restrictions and Forfeiture Risk

- These grants are restricted (1) for half the shares, until five years after the grant date; and, (2) for the balance, until 10 years after the grant date or retirement, whichever occurs later. These restricted periods are not subject to acceleration, except upon death, and thus, shares may remain subject to restriction for many years after an executive's retirement.
- During the restricted period, the executive receives the same cash dividends as a holder of regular common stock and may vote the shares; however, the executive may not sell or transfer the shares, or use them as collateral.
- The shares also remain subject to forfeiture during the restricted period in case of an unapproved early termination of employment or in case the executive is found to have engaged in activity that is detrimental to the Company. Detrimental activity may include conduct that violates the Company's Ethics or Conflicts of Interest policies.

Selected pages from the ExxonMobil proxy statement, regarding

2008 Executive Compensation

Table of Contents

Index to Financial Statements

EXECUTIVE COMPENSATION TABLES

Summary Compensation Table for 2008

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)*	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
R.W. Tillerson	2008	1,870,000	4,000,000	7,807,523	0	0	8,290,253	446,826	22,414,602
Chairman and CEO	2007	1,750,000	3,360,000	5,675,362	0	0	5,511,588	429,792	16,726,742
	2006	1,500,000	2,800,000	4,159,713	0	0	4,067,544	482,238	13,009,495
D.D. Humphreys	2008	910,000	2,364,000	3,895,851	0	0	4,599,191	108,989	11,878,031
PFO; Senior Vice President	2007	830,000	1,859,000	2,421,168	0	0	3,919,806	86,689	9,116,663
	2006	750,000	1,750,000	1,768,252	0	0	2,784,795	97,331	7,150,378
H.R. Cramer	2008	843,333	1,744,598	3,383,296	0	0	3,215,127	87,522	9,273,876
Vice President;	2007	807,917	1,586,000	3,645,262	0	0	2,294,584	86,202	8,419,965
President, ExxonMobil Fuels Marketing Company	2006	772,917	1,586,176	2,921,188	0	0	1,833,188	93,148	7,206,617
C.W. Matthews *Vice President; General Counsel*	2008	855,000	1,477,305	5,490,643	0	0	1,781,214	96,065	9,700,227
S.D. Pryor *Vice President; President, ExxonMobil Chemical Company*	2008	905,000	1,744,598	3,668,776	0	0	3,571,656	311,614	10,201,644
RETIRED									
J.S. Simon	2008	593,337	0	18,366,191	0	0	714,029	103,747	19,777,304
Senior Vice President	2007	995,000	2,150,000	9,168,388	0	0	2,585,221	135,133	15,033,742
and Director *(Retired 6/1/2008)*	2006	935,000	2,150,000	3,284,506	0	0	2,088,907	121,735	8,580,148
M.E. Foster	2008	314,233	0	12,113,088	0	0	554,968	76,845	13,059,134
Vice President; *President, ExxonMobil Production Company* *(Retired 4/1/2008)*	2007	803,750	1,859,000	7,805,893	0	0	2,930,181	116,389	13,515,213

* In accordance with disclosure regulations, the valuation of "Stock Awards" in this table represents the compensation cost of awards recognized for financial statement purposes under Statement of Financial Accounting Standards No. 123, as revised (FAS 123R).

As described in more detail under "Stock Awards" below, the stock award values shown in 2008 for Messrs. Simon and Foster reflect the recognition of expense for outstanding awards triggered by their retirements. ***This is not a severance payment or a new award.*** Of the underlying stock awards for Messrs. Simon and Foster, more than 93 and 96 percent, respectively, remain restricted from transfer and subject to forfeiture for a number of years.

The stock award value shown in 2008 for Mr. Matthews includes the effect of using a shorter amortization schedule since he is nearing standard retirement age.

Table of Contents

Index to Financial Statements

Employment Arrangements

ExxonMobil's Compensation Committee believes senior executives should be "at will" employees of the Corporation. Accordingly the CEO and other executive officers, including the other officers named in these tables, ***do not have employment contracts, severance agreements, or change-in-control arrangements*** with the Company.

Salary

- Effective January 1, 2009, Mr. Tillerson's annual salary increased to $2,057,000, and Mr. Humphreys' annual salary increased to $1,010,000.
- The 2008 and 2009 salary increases reflect adjustments to the competitive position of the base salary program for U.S. executives, taking into account individual experience and level of responsibility. See the "Pay Awarded to Named Executive Officers" section beginning on page 32.
- The 2008 salary for Messrs. Simon and Foster includes pay in lieu of vacation that they received due to their retirements. Refer to page 48 for information on unused vacation.

Bonus

- As described in more detail in the "Compensation Discussion and Analysis" (CD&A), the 2008 bonus shown was paid half in cash at the time of grant. The Company delays payment of the balance until cumulative earnings reach $5.75 per share.
- Delayed bonus amounts do not earn interest.
- The bonus and the stock awards described below meet the requirements of Section 162(m) of the Internal Revenue Code for tax deductibility, which is explained in more detail on page 34.

Stock Awards

- In accordance with disclosure regulations, the valuation of stock awards in this table represents the compensation cost of awards recognized for financial statement purposes under Statement of Financial Accounting Standards No. 123, as revised (FAS 123R).
- The amounts include portions of restricted stock grants in 2002 through 2008 that were expensed in 2008 based on the following amortization schedule:
  - Awards granted in 2002 through 2005 are amortized over the period of restriction.
  - Awards granted after 2005 are amortized over the period of restriction or the time between the grant date and age 65, whichever is less.
- The 2008 grant was made November 25, and therefore only one month of amortized expense for 2008 is reflected in the total.
- If an executive retires in the reportable year, the remaining amortization expense for all outstanding awards is accelerated and recognized in the year of retirement (see the specific discussion regarding Messrs. Simon and Foster below).
- The remaining value of all outstanding Career Shares described on page 26 was fully expensed in 2006.
- The amount shown for stock awards also includes the following:
  - For Messrs. Cramer and Pryor, the retention awards made by Mobil Corporation before the merger are included. Retention awards are stock units settled in cash after retirement. During employment, dividend equivalents are credited and reinvested in additional units up to the total dollar amount of the retention award. Both Messrs. Cramer and Pryor reached the dividend reinvestment cap in 2007, and, therefore, they did not receive any further dividend equivalents on these awards in 2008. These awards were expensed at time of grant, but the incremental

Table of Contents

Index to Financial Statements

cost of the awards based on changes in share price is expensed quarterly on a mark-to-market method. The lower share price resulted in negative values for 2008 for Mr. Cramer (-$425,090) and for Mr. Pryor (-$212,505), which are included in the table.

- For Mr. Simon, the scheduled amortization expense is through his retirement date of June 1, 2008, and reflects the expensing of the unamortized remaining balance of six years' worth of outstanding awards. Mr. Simon did not receive a 2008 restricted stock award. His Career Shares remained restricted for seven months after retirement, and his restricted stock grants outstanding from 2002 through 2007 will remain restricted for up to nine years and six months following his retirement.
- For Mr. Foster, the scheduled amortization expense is through his retirement date of April 1, 2008, and reflects the expensing of the unamortized remaining balance of six years' worth of outstanding awards. Mr. Foster did not receive a 2008 restricted stock award. His Career Shares remained restricted for nine months after retirement, and his restricted stock grants outstanding from 2002 through 2007 will remain restricted for up to nine years and eight months following his retirement.

• The terms of all restricted stock granted between 2002 and 2008 are the same and are provided on page 25.

• Dividends on stock awards are not shown in the table because those amounts are reflected in the grant date fair value reported in the "Grants of Plan-Based Awards" table.

Change in Pension Value and Nonqualified Deferred Compensation Earnings

The following table breaks down the 2008 amounts shown in this column in the "Summary Compensation Table."

Name	Change in Pension Value ($)	Nonqualified Deferred Compensation Earnings ($)	Total ($)
R.W. Tillerson	8,290,253	0	8,290,253
D.D. Humphreys	4,599,191	0	4,599,191
H.R. Cramer	3,215,127	0	3,215,127
C.W. Matthews	1,781,214	0	1,781,214
S.D. Pryor	3,571,656	0	3,571,656
J.S. Simon	714,029	0	714,029
M.E. Foster	552,298	2,670	554,968

Pension Value

• The change in pension value shown in the table is the increase between year-end 2007 and year-end 2008 (or retirement, if earlier) in the present value of each executive's pension benefits under the plans described in more detail in the text following the "Pension Benefits" table on page 44. Messrs. Simon and Foster retired on June 1, 2008, and April 1, 2008, respectively, resulting in lower pension accruals than those for the other Named Executive Officers in the table.

• For each year end, the data reflects an annuity beginning at age 60 (or current age if over 60) equal to 1.6 percent of the participant's covered compensation multiplied by year-end service. These values are converted to lump sums using the plan's applicable factors and then discounted in the case of employees under age 60 to present values based on the time difference between the individual's age at year-end 2007 and age 60 (and at year-end 2008 and age 60) using the interest rates for financial reporting of pension obligations as of each year end. The difference between the two year-end amounts represents the annual increase in the value of the pension shown in the "Summary Compensation Table."

Table of Contents

Index to Financial Statements

- The lump sum interest rate applied for an employee who worked through the end of 2007 was 4.75 percent. The lump sum interest rate applied for an employee who worked through the end of 2008 was 4.25 percent. In the second quarter of 2008 (when Messrs. Simon and Foster retired), the lump sum interest rate was 4.5 percent. The rate used to discount the age 60 lump sum to a value at current age for those under age 60 was 6.25 percent for 2007 and 2008.
- The pension accrual shown for the two retired Named Executive Officers reflects their additional months of service in 2008 plus the impact of the lower interest rate used in calculating their lump sum benefits, as described in the paragraph above.
  - For Mr. Simon, who worked through May 31, 2008, and retired June 1, 2008, the pension accrual shown in the table represents five additional months of service in 2008 on the value of his lump sum pension distribution and the effect of the lower interest rate used in computing the lump sum.
  - For Mr. Foster, who worked through March 31, 2008, and retired April 1, 2008, the pension accrual shown in the table represents three additional months of service in 2008 on the value of his lump sum pension distribution and the effect of the lower interest rate used in computing the lump sum.

Nonqualified Deferred Earnings

- The portion of annual earnings on each executive's principal balance under the Corporation's nonqualified supplemental savings plan that exceeds 120 percent of the long-term Applicable Federal Rate, compounded monthly, as prescribed under Section 1274(d) of the Internal Revenue Code, is required to be disclosed. As of January 1, 2008, the basis for the interest rate during the term of a participant's employment was changed from the Citibank prime lending rate to 120 percent of the long-term Applicable Federal Rate.
- For Mr. Foster, the amount reported in 2008 is interest exceeding 120 percent of the long-term Applicable Federal Rate on the lump sum nonqualified pension payments during the six-month deferral period required by Section 409A of the Internal Revenue Code. The deferred payment bore interest at the Citibank prime lending rate on the date of retirement.

All Other Compensation

The following table breaks down the amounts included in the "All Other Compensation" column of the "Summary Compensation Table." Note the table has been changed from prior years as follows: removed the column for "Club Memberships" since the Company discontinued reimbursement effective January 1, 2007; and added a new column labeled "Relocation" since a Named Executive Officer had relocation costs in 2008.

Name	Life Insurance ($)	Savings Plan ($)	Personal Security ($)	Personal Use of Company Aircraft ($)	Personal Use of Company Properties ($)	Personal Use of Company Car ($)	Relocation ($)	Financial Planning ($)	Tax Assistance ($)	Total ($)
R.W. Tillerson	38,390	130,900	222,985	41,980	3,271	0	0	9,300	0	446,826
D.D. Humphreys	28,618	63,700	3,281	0	4,090	0	0	9,300	0	108,989
H.R. Cramer	17,338	59,033	1,835	0	0	16	0	9,300	0	87,522
C.W. Matthews	26,915	59,850	0	0	0	0	0	9,300	0	96,065
S.D. Pryor	18,593	63,350	810	0	0	528	148,275	7,500	72,558	311,614
J.S. Simon	58,115	30,333	2,469	0	430	0	0	12,400	0	103,747
M.E. Foster	46,965	15,050	1,246	0	0	1,184	0	12,400	0	76,845

Table of Contents

Index to Financial Statements

Life Insurance

- The Company offers senior executives term life insurance or a Company-paid death benefit.
- Coverage under either option equals four times base salary until age 65, and a declining multiple thereafter until age 75, at which point the multiple remains at 2.5 times salary.
- For executives with life insurance coverage, the premium cost in any year depends on overall financial and mortality experience under the group policy.
- For executives electing the death benefit, there is no cash cost until the executive dies, as benefits are paid directly by the Company.
- The amount shown is based on Internal Revenue Service tables used to value the term cost of such coverage. This valuation is applied since the actual life insurance premium is a single payment for a large group of executives that does not represent the cost of insuring one specific individual and because several of the Named Executive Officers have elected the death benefit, the long-term cost of which is comparable to the insurance.
- The Company eliminated the executive term life insurance and Company-paid death benefit for all newly eligible executives as of October 1, 2007, and retained it for all current participants, including the Named Executive Officers.

Savings Plan

- The amount shown is the value of Company-matching contributions under ExxonMobil's tax-qualified defined contribution (401(k)) plan and Company credits under the related nonqualified supplemental plan.
- The nonqualified supplemental plan provides all affected employees with the 7-percent Company credit to which they would otherwise be entitled as a matching contribution under the qualified plan but for limitations under the Internal Revenue Code. The Company credit was previously 6 percent and was increased to 7 percent effective January 1, 2008. All affected employees participate in the nonqualified supplemental plan on the same basis.
- The value of the credits to the nonqualified supplemental plan is also disclosed in the "Nonqualified Deferred Compensation" table on page 47.

Personal Security

- The Company provides security for its employees as appropriate based on an assessment of risk. The assessment includes consideration of the employee's position and work location.
- The Company does not consider any such security costs to be personal benefits since these costs arise from the nature of the employee's employment by the Company; however, the disclosure regulations require certain security costs to be reported as personal benefits.
- The amounts shown in the table include the following types of security related costs: security systems at executive residences; security services and personnel (at residences and/or during personal travel); car and personal security driver; and Company mobile phones. Costs of security relating to travel for business purposes are not included.
- Cars provided for security reasons and used primarily for commuting are valued based on the annualized cost of the car plus maintenance and fuel. Reported costs for rental cars utilized due to security concerns during personal travel are the actual incremental costs.
- For security personnel employed by the Company, the cost is the actual incremental cost of expenses incurred by the security personnel. Total salary, wages, and benefits for security personnel are not allocated because the Company already incurs these costs for business purposes.

Table of Contents

Index to Financial Statements

- For security contractors, the cost is the actual incremental cost of such contractors associated with the executive's personal time.
- For Mr. Tillerson, the amount shown includes $34,060 for car, $57,513 for personal security driver, and $122,182 for residential security. The remainder is for mobile phones and other communications equipment for conducting business in a secure manner.

Aircraft

- Incremental cost for personal use of the aircraft is based on direct operating costs (fuel, airport fees, incremental pilot costs, etc.) and does not include capital costs of the aircraft since the Company already incurs these capital costs for business purposes.
- For security reasons, the Board requires the Chairman and CEO to use Company aircraft for both business and personal travel.
- The Committee considers these costs to be necessary, security-related business expenses rather than perquisites, but per the disclosure regulations we report the incremental cost of aircraft usage for personal travel.

Properties

- The Company owns or leases various venues for the purpose of business entertainment, including boxes and season tickets to sporting events and recreation and conference retreat properties. When these venues are not otherwise in use for business entertainment, the tickets and properties may be available for use by Company executives and other personnel.
- The table shows the incremental cost incurred for any personal use of these venues by the Named Executive Officers.
- Cost for this purpose is based solely on incremental operating costs (catering, transportation, incremental employee or contractor costs, etc.) and does not include annual or capital costs of these venues since the Company already incurs these costs for business purposes.

Car

- Incremental cost for personal use of company car by executives other than Mr. Tillerson (whose car-related expenses are included under "Personal Security") is based on an assumed cost in 2008 of $0.505 per mile for January through June, and $0.585 for July through December. Driver personnel costs are not allocated because the Company already incurs these costs for business purposes.

Financial Planning

- The Company provides financial planning services to senior executives, which includes tax preparation. This benefit is valued based on the actual charge for the services.

Relocation

- The Company provides relocation assistance for all transferred professionals and executives. All affected employees participate in the Company's relocation program on the same basis. The amount shown is the relocation costs reimbursed to the executive or paid on behalf of the executive.

Tax Assistance

- The amount shown is the aggregate amount of payments made on the executive's behalf by the Corporation during the year for the payment of taxes related to relocation costs. The Company discontinued providing tax assistance on financial planning effective January 1, 2008.

Selected pages from the ExxonMobil proxy statement, regarding

2007 Executive Compensation

Table of Contents

Index to Financial Statements

EXECUTIVE COMPENSATION TABLES

Summary Compensation Table for 2007

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)*	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
R.W. Tillerson *Chairman and CEO*	2007	1,750,000	3,360,000	5,675,362	0	0	5,511,588	429,792	16,726,742
	2006	1,500,000	2,800,000	4,159,713	0	0	4,067,544	482,238	13,009,495
D.D. Humphreys *PFO; Senior Vice President*	2007	830,000	1,859,000	2,421,168	0	0	3,919,806	86,689	9,116,663
	2006	750,000	1,750,000	1,768,252	0	0	2,784,795	97,331	7,150,378
S.R. McGill *Senior Vice President (Retired 8/1/07)*	2007	714,899	1,260,000	18,233,505	0	0	743,736	112,771	21,064,911
	2006	935,000	2,150,000	3,976,673	0	0	2,037,297	115,846	9,214,816
J.S. Simon *Senior Vice President and Director*	2007	995,000	2,150,000	9,168,388	0	0	2,585,221	135,133	15,033,742
	2006	935,000	2,150,000	3,284,506	0	0	2,088,907	121,735	8,580,148
H.R. Cramer *Vice President; President, ExxonMobil Fuels Marketing Company*	2007	807,917	1,586,000	3,645,262	0	0	2,294,584	86,202	8,419,965
	2006	772,917	1,586,176	2,921,188	0	0	1,833,188	93,148	7,206,617
M.E. Foster *Vice President; President, ExxonMobil Production Company*	2007	803,750	1,859,000	7,805,893	0	0	2,930,181	116,389	13,515,213
P.E. Sullivan *Vice President; General Tax Counsel (Retired 5/24/07)*	2007	252,754	0	9,049,979	0	0	554,607	59,518	9,916,858

* In accordance with disclosure regulations, the valuation of "Stock Awards" in this table represents the compensation cost of awards recognized for financial statement purposes for 2007 and 2006, respectively, under Statement of Financial Accounting Standards No. 123, as revised (FAS 123R).

As described in more detail under "Stock Awards" below, the stock award values shown in 2007 for Messrs. McGill and Sullivan reflect the recognition of expense for outstanding awards triggered by their retirements. **This is not a severance payment or a new award.** Of the underlying stock awards for Messrs. McGill and Sullivan, more than 87 and 89 percent, respectively, remain restricted from transfer and subject to forfeiture for a number of years.

The stock award values shown in 2007 for Messrs. Simon and Foster include the effect of using a shorter amortization schedule since they are nearing standard retirement age.

Employment Arrangements

ExxonMobil's Compensation Committee believes senior executives should be "at-will" employees of the Corporation. Accordingly, the CEO and other executive officers, including the other officers named in these tables, **do not have employment contracts, severance agreements, or change-in-control arrangements** with the Company.

Salary

- Effective January 1, 2008, Mr. Tillerson's annual salary increased to $1,870,000, and Mr. Humphreys' annual salary increased to $910,000.

Table of Contents

Index to Financial Statements

- The 2007 and 2008 salary increases reflect adjustments to the competitive position of the base salary program for U.S. executives, taking into account individual experience and level of responsibility.
- Refer to the "Pay Awarded" section beginning on page 30 for the discussion regarding the 2007 salary increases.
- Mr. McGill's 2007 salary includes pay in lieu of vacation that he received due to his retirement. Refer to page 45 for information on unused vacation.

Bonus

- As described in more detail in the "Compensation Discussion and Analysis" (CD&A) on page 22, the 2007 bonus shown was paid half in cash at the time of grant. Payment of the balance is delayed by the Company until cumulative earnings reach $5.00 per share.
- Delayed bonus amounts do not earn interest.
- The bonus and the stock awards described below meet the requirements of Section 162(m) of the Internal Revenue Code for tax deductibility, which is explained in more detail on page 28.

Stock Awards

- In accordance with disclosure regulations, the valuation of stock awards in this table represents the compensation cost of awards recognized for financial statement purposes for 2007 and 2006, respectively, under Statement of Financial Accounting Standards No. 123, as revised (FAS 123R).
- The amounts include portions of restricted stock grants in 2002 through 2007 that were expensed in 2007 based on the amortization schedule. The 2007 grant was made November 28, and therefore only one month of amortized expense for 2007 is reflected in the totals.
- The amortization schedule for awards granted in 2002 through 2005 is the period of restriction. The amortization schedule for awards granted after 2005 is the period of restriction or the time period between the grant date and age 65, whichever is less.
- If an executive retires in the reportable year, the remaining amortization expense for all outstanding awards is accelerated and recognized in the year of retirement (see the specific discussion regarding Messrs. McGill and Sullivan below).
- The terms of all restricted stock granted between 2002 and 2007 are the same and are provided on page 23.
- The remaining value of all outstanding Career Shares described on page 24 was fully expensed in 2006.
- The amount shown for stock awards also includes the following:
  - For Mr. Cramer, the retention awards made by Mobil Corporation before the merger. Retention awards are stock units settled in cash after retirement. During employment, dividend equivalents are credited and reinvested in additional units up to the total dollar amount of the retention award. These awards were expensed at time of grant, but the incremental cost of the awards based on changes in share price is expensed quarterly on a mark-to-market method. The value of this incremental expense in 2007 for Mr. Cramer was $737,951 and is included in the table.
  - For Mr. McGill, the scheduled amortization expense is through his retirement date of August 1, 2007, and reflects acceleration (for accounting purposes only) of the unamortized portion of five years' worth of outstanding awards. Mr. McGill did not receive a 2007 restricted stock award. His Career Shares remained restricted for five months after retirement, and his restricted stock grants outstanding from 2002 through 2006 will remain restricted for up to nine years and four months following his retirement.

Table of Contents

Index to Financial Statements

- For Mr. Sullivan, the scheduled amortization expense is through his retirement date of May 24, 2007, and acceleration (for accounting purposes only) of the unamortized portion of five years' worth of outstanding awards. Mr. Sullivan did not receive a 2007 restricted stock award. His Career Shares remained restricted for seven months after retirement, and his restricted stock grants outstanding from 2002 through 2006 will remain restricted for up to nine years and six months following his retirement.

- Since both Messrs. Simon and Foster reach age 65 in 2008, their awards granted after 2005 are amortized over a shorter period of time resulting in a larger valuation compared to Messrs. Tillerson and Humphreys.
- Dividends on stock awards are not shown in the table because those amounts are reflected in the grant date fair value reported in the "Grants of Plan-Based Awards" table.

Change in Pension Value and Nonqualified Deferred Compensation Earnings

The following table breaks down the 2007 amounts shown in this column in the "Summary Compensation Table."

Name	Change in Pension Value ($)	Nonqualified Deferred Compensation Earnings ($)	Total ($)
R.W. Tillerson	5,503,814	7,774	5,511,588
D.D. Humphreys	3,914,385	5,421	3,919,806
S.R. McGill	550,994	192,742	743,736
J.S. Simon	2,575,468	9,753	2,585,221
H.R. Cramer	2,273,928	20,656	2,294,584
M.E. Foster	2,921,630	8,551	2,930,181
P.E. Sullivan	419,287	135,320	554,607

Pension Value

- The change in pension value shown in the table is the increase between year-end 2006 and year-end 2007 (or retirement) in the present value of each executive's pension benefits under the plans described in more detail in the text following the "Pension Benefits" table on page 41. Messrs. McGill and Sullivan retired on August 1, 2007, and May 24, 2007, respectively, resulting in lower pension accruals than those for the other Named Executive Officers in the table.
- For each year end, the data reflects an annuity beginning at age 60 (or current age if over 60) equal to 1.6 percent of the participant's covered compensation multiplied by year-end service. These values are converted to lump sums using the plan's applicable factors and then discounted in the case of employees under age 60 to present values based on the time difference between the individual's age at year-end 2006 and age 60 (and at year-end 2007 and age 60) using the interest rates for financial reporting of pension obligations as of each year end. The difference between the two year-end amounts represents the annual increase in the value of the pension shown in the "Summary Compensation Table."
- The lump sum interest rate applied for an employee who worked through the end of 2006 was 4.75 percent. The same lump sum interest rate applied to an employee who worked through the end of 2007. In the second and third quarters of 2007 (when Messrs. McGill and Sullivan retired), the lump sum interest rate was 4.5 percent. The rate used to discount the age 60 lump sum to a value at current age for those under age 60 was 6 percent for 2006 and 6.25 percent for 2007.
- The pension accrual shown for the two retired Named Executive Officers reflects their additional months of service in 2007 plus the impact of the lower interest rate used in calculating their lump sum benefits, as described in the paragraph above.

Table of Contents

Index to Financial Statements

- For Mr. McGill, who worked through July 31, 2007, and retired August 1, 2007, the pension accrual shown in the table represents seven additional months of service in 2007 on the value of his lump sum pension distribution and the effect of the lower interest rate used in computing the lump sum.
- For Mr. Sullivan, who worked through May 23, 2007, and retired May 24, 2007, the pension accrual shown in the table represents five additional months of service in 2007 on the value of his lump sum pension distribution and the effect of the lower interest rate used in computing the lump sum.

Nonqualified Deferred Earnings

- This is the portion of annual earnings on each executive's principal balance under the Corporation's nonqualified supplemental savings plan that exceeds 120 percent of the long-term Applicable Federal Rate, compounded monthly, as prescribed under Section 1274(d) of the Internal Revenue Code. The federal rate averaged approximately 6 percent during the year. In 2007, principal balances under the supplemental savings plan bore interest at the Citibank prime lending rate, which averaged approximately 8 percent during the year. As discussed on page 32, the basis for the interest rate in the nonqualified supplemental savings plan changed as of January 1, 2008, to the long-term Applicable Federal Rate.
- For Messrs. McGill and Sullivan, this also includes interest exceeding 120 percent of the long-term Applicable Federal Rate on the lump sum nonqualified pension payments during the six-month deferral period required by Section 409A of the Internal Revenue Code.

All Other Compensation

The following table breaks down the amounts included in the "All Other Compensation" column of the "Summary Compensation Table."

Name	Life Insurance ($)	Savings Plan ($)	Personal Security ($)	Personal Use of Company			Club Memberships (Discontinued 1/1/07) ($)	Financial Planning ($)	Tax Assistance ($)	Total ($)
				Aircraft ($)	Properties ($)	Car ($)				
R.W. Tillerson	35,690	107,250	229,331	41,122	0	0	1,157	9,150	6,092	429,792
D.D. Humphreys	16,994	51,875	3,262	0	0	0	0	9,150	5,408	86,689
S.R. McGill	52,273	36,550	2,737	0	0	0	931	12,400	7,880	112,771
J.S. Simon	31,363	61,950	10,262	0	17,000	0	0	9,150	5,408	135,133
H.R. Cramer	16,615	50,725	1,823	0	0	0	922	9,150	6,967	86,202
M.E. Foster	25,265	50,475	7,488	0	15,000	933	1,678	9,150	6,400	116,389
P.E. Sullivan	20,275	17,415	0	0	0	0	1,401	12,400	8,027	59,518

Life Insurance

- The Company offers senior executives term life insurance or a Company-paid death benefit.
- Coverage under either option equals four times base salary until age 65, and a declining multiple thereafter until age 75, at which point the multiple remains at 2.5 times salary.
- For executives with life insurance coverage, the premium cost in any year depends on overall financial and mortality experience under the group policy.
- For executives electing the death benefit, there is no cash cost until the executive dies, as benefits are paid directly by the Company.
- The amount shown is based on Internal Revenue Service tables used to value the term cost of such coverage. This valuation is applied since the actual life insurance premium is a single payment for a

Table of Contents

Index to Financial Statements

large group of executives that does not represent the cost of insuring one specific individual and because several of the Named Executive Officers have elected the death benefit, the long-term cost of which is comparable to the insurance.

- The Company eliminated the executive term life insurance and Company-paid death benefit for all newly eligible executives as of October 1, 2007, and retained it for all current participants, including the Named Executive Officers, as described on page 32.

Savings Plan

- The amount shown is the value of Company-matching contributions under ExxonMobil's tax-qualified defined contribution (401(k)) plan and Company credits under the related nonqualified supplemental plan.
- All affected employees participate in the nonqualified supplemental plan on the same basis.
- The nonqualified supplemental plan provides all affected employees with the 6-percent Company credit to which they would otherwise be entitled as a matching contribution under the qualified plan but for limitations under the Internal Revenue Code. The Company credit was increased to 7 percent effective January 1, 2008 (see page 32).
- The value of the credits to the nonqualified supplemental plan is also disclosed in the "Nonqualified Deferred Compensation" table on page 44.

Personal Security

- The Company provides security for its employees as appropriate based on an assessment of risk. The assessment includes consideration of the employee's position and work location.
- The Company does not consider any such security costs to be personal benefits since these costs arise from the nature of the employee's employment by the Company; however, the disclosure regulations require certain security costs to be reported as personal benefits.
- The amounts shown in the table include the following types of security related costs: security systems at executive residences; security services and personnel (at residences and/or during personal travel); car and personal security driver; and Company mobile phones. Costs of security relating to travel for business purposes is not included.
- Cars used primarily for commuting are valued based on the annualized cost of the car plus maintenance and fuel. Reported costs for rental cars utilized due to security concerns during personal travel are the actual incremental costs.
- For security personnel employed by the Company, the cost is the actual incremental cost of expenses incurred by the security personnel. Total salary, wages, and benefits for security personnel are not allocated because the Company already incurs these costs for business purposes.
- For security contractors, the cost is the actual incremental cost of such contractors associated with the executive's personal time.

Aircraft

- Incremental cost for personal use of the aircraft is based on direct operating costs (fuel, airport fees, incremental pilot costs, etc.) and does not include capital costs of the aircraft since the Company already incurs these capital costs for business purposes.
- For security reasons, the Board requires the Chairman and CEO to use Company aircraft for both business and personal travel.
- The Committee considers these costs necessary business expenses rather than perquisites, but per the disclosure regulations, we report the incremental cost of aircraft usage for personal travel.

Table of Contents

Index to Financial Statements

Properties

- The Company owns or leases various venues for the purpose of business entertainment, including boxes and season tickets to sporting events and recreation and conference retreat properties. When these venues are not otherwise in use for business entertainment, the tickets and properties may be available for use by Company executives and other personnel.
- The table shows the incremental cost incurred for any personal use of these venues by the Named Executive Officers.
- Cost for this purpose is based solely on incremental operating costs (catering, transportation, incremental employee or contractor costs, etc.) and does not include annual or capital costs of these venues since the Company already incurs these costs for business purposes.

Car

- Incremental cost for personal car usage is based on an assumed cost of $0.485 per mile. Driver personnel costs are not allocated because the Company already incurs these costs for business purposes.

Club Memberships

- The Company discontinued the reimbursement of country club memberships effective January 1, 2007. The amounts shown in the table were incurred in the last months of 2006 and reported as compensation to the executive in 2007, consistent with the Corporation's practice of following the IRS rule that permits reporting imputed income amounts based on a November 1 through October 31 fiscal year.

Financial Planning

- The Company provides financial planning services to senior executives, which include tax preparation. This benefit is valued based on the actual charge for the services.

Tax Assistance

- The amount shown is the aggregate amount of payments made on the executive's behalf by the Corporation during the year for the payment of taxes related to financial planning and country clubs. The Company discontinued providing tax assistance on financial planning effective January 1, 2008 (see page 32).

Grants of Plan-Based Awards for 2007

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units	All Other Option Awards: Number of Securities Underlying Options	Exercise or Base Price of Option Awards	Grant Date Fair Value of Stock and Option Awards ($)
Name	Grant Date	Threshold ($)	Target ($)	Maximum ($)	Threshold (#)	Target (#)	Maximum (#)	(#)	(#)	($/Sh)	
R.W. Tillerson	11/28/2007	0	0	0	0	0	0	185,000	0	0	16,120,900
D.D. Humphreys	11/28/2007	0	0	0	0	0	0	90,800	0	0	7,912,312
S.R. McGill	—	0	0	0	0	0	0	0	0	0	0
J.S. Simon	11/28/2007	0	0	0	0	0	0	107,000	0	0	9,323,980
H.R. Cramer	11/28/2007	0	0	0	0	0	0	77,000	0	0	6,709,780
M.E. Foster	11/28/2007	0	0	0	0	0	0	90,800	0	0	7,912,312
P.E. Sullivan	—	0	0	0	0	0	0	0	0	0	0

The awards granted in 2007 are in the form of restricted stock.

Selected pages from the ExxonMobil proxy statement, regarding

2006
Executive Compensation

Table of Contents

Index to Financial Statements

EXECUTIVE COMPENSATION TABLES

Summary Compensation Table for 2006

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compen-sation ($)	Change in Pension Value and Nonqualified Deferred Compen-sation Earnings ($)	All Other Compen-sation ($)	Total ($)
R.W. Tillerson *Chairman and CEO*	2006	1,500,000	2,800,000	4,159,713	0	0	4,067,544	482,238	13,009,495
D.D. Humphreys *PFO; Senior Vice President*	2006	750,000	1,750,000	1,768,252	0	0	2,784,795	97,331	7,150,378
S.R. McGill *Senior Vice President*	2006	935,000	2,150,000	3,976,673	0	0	2,037,297	115,846	9,214,816
J.S. Simon *Senior Vice President and Director*	2006	935,000	2,150,000	3,284,506	0	0	2,088,907	121,735	8,580,148
H.R. Cramer *Vice President; President, ExxonMobil Fuels Marketing Company*	2006	772,917	1,586,176	2,921,188	0	0	1,633,188	93,148	7,206,617
E.G. Galante *Senior Vice President (Retired – 2/1/06)*	2006	182,823	0	17,003,578*	0	0	150,622	29,132	17,366,155

* As described in more detail under "Stock Awards" below, this amount reflects the accounting expense for outstanding awards triggered by Mr. Galante's retirement. This is not a severance payment or a new award. Of the underlying stock awards for Mr. Galante, more than 95 percent remain restricted from transfer and are subject to forfeiture for a number of years.

Employment Arrangements

ExxonMobil's Compensation Committee believes senior executives should be "at will" employees of the Corporation. Accordingly, the CEO and other executive officers, including the other officers named in these tables, do not have employment contracts, severance agreements, or change-in-control arrangements with the Company.

Salary

Effective January 1, 2007, Mr. Tillerson's annual salary increased to $1,750,000, and Mr. Humphreys' annual salary increased to $830,000.

Bonus

As described in more detail in the "Compensation Discussion and Analysis" (CD&A), the 2006 bonus shown was paid half in cash at the time of grant. Payment of the balance is deferred by the Company until cumulative earnings reach $4.25 per share. Deferred bonus amounts do not earn interest. The bonus and the stock awards described below meet the requirements of Section 162(m) of the U.S. Internal Revenue Code for tax deductibility, which is explained in more detail on pages 29-30.

Table of Contents

Index to Financial Statements

Stock Awards

In accordance with SEC rules, the valuation of stock awards in this table represents the compensation cost of awards recognized for financial statement purposes for 2006 under Statement of Financial Accounting Standards No. 123, as revised (FAS 123R). The amounts include portions of restricted stock grants in 2002-2006 that were expensed in 2006 based on the amortization schedule. The 2006 grant was made November 28, and therefore only one month of amortized expense for 2006 is reflected in the total. The amortization schedule for awards granted in 2002-2005 is the period of restriction. The amortization schedule for awards granted after 2005 is the period of restriction or the time period between the grant date and age 65, whichever is less. These amortization schedules apply unless an executive retires in the reportable year, in which case the amortization expense for all outstanding awards is accelerated into the year of retirement (see the specific discussion regarding Mr. Galante below). The terms of all restricted stock granted between 2002 and 2006 are the same and are provided on pages 26-27 of the CD&A and page 35 under the "Grants of Plan-Based Awards" table.

Also included in the value of stock awards is the remaining cost of "Career Shares" granted in 2001 and prior years. Career Shares are shares of restricted stock with restrictions that lapse the first day of the calendar year following the year of retirement. During the period of restriction, dividends on the shares are paid to the executive, and the shares are subject to forfeiture on the same terms as later restricted stock grants. Prior to 2006, the expense for Career Shares was amortized based on the number of years between the grant date and age 65. If an executive retired prior to age 65, the unamortized portion of all outstanding awards was accelerated in the year when restrictions lapse. The full cost of the remaining unamortized value of the Career Shares in 2006 is reflected in the stock awards column. However, shares under this program are still restricted for the Named Executive Officers, except Mr. Galante as described below. The accounting expense attributable to Career Shares for 2006 and shown in the stock award column of the "Summary Compensation Table" is $528,539 for Mr. Tillerson; $442,577 for Mr. Humphreys; $475,912 for Mr. McGill; $453,732 for Mr. Simon; $498,785 for Mr. Cramer; and $500,037 for Mr. Galante.

For Mr. Cramer, stock awards also include retention awards made by Mobil Corporation before the merger. Retention awards are stock units settled in cash after retirement. During employment, dividend equivalents are credited and reinvested in additional units. These retention awards were expensed at time of grant, but the incremental cost of the awards based on changes in share price is expensed quarterly on a mark-to-market method. The value of this incremental expense in 2006 for Mr. Cramer was $417,189 and is included in the table.

The amount reported for Mr. Galante represents the scheduled amortization expense through his retirement date of February 1, 2006, and acceleration (for accounting purposes only) of the unamortized portion of seven years' worth of outstanding awards. Mr. Galante did not receive a 2006 restricted stock award. His Career Shares remained restricted for 11 months, and his restricted stock grants from 2002-2005 will remain restricted for up to nine years and 10 months following his retirement.

Dividends on stock awards are not shown in the table because those amounts are reflected in the grant date fair value reported in the "Grants of Plan-Based Awards" table.

Change in Pension Value and Nonqualified Deferred Compensation Earnings

The totals shown in this column comprise primarily the change in pension value under the pension plans discussed below. These are: $4,061,653 for Mr. Tillerson; $2,780,265 for Mr. Humphreys; $2,029,593 for Mr. McGill; $2,080,451 for Mr. Simon; $1,814,223 for Mr. Cramer; and $148,396 for Mr. Galante.

Except for Mr. Galante who retired on February 1, 2006, the change in pension value shown in the table is the increase between year-end 2005 and 2006 in the present value of each executive's pension benefits under the plans described in more detail in the text following the "Pension Benefits" table. For each year-end, the data reflects an annuity beginning at age 60 (or current age if over 60) equal to 1.6 percent of the participant's covered compensation multiplied by year-end service. These values are

Table of Contents

Index to Financial Statements

converted to lump sums using the plans' applicable factors and then discounted in the case of employees under age 60 to present values based on the time difference between the individual's age at year-end 2005 and age 60 (and at year-end 2006 and age 60) using the interest rate for financial reporting of pension obligations. The difference between the two year-end amounts represents the annual increase in the value of the pension shown in the "Summary Compensation Table." The plans' lump sum interest rate for an employee who worked through the end of 2005 was 4.25 percent (vs. 4.75 percent for an employee who worked through the end of 2006) and the applicable discount rate was 5.75 percent (vs. 6.0 percent for 2006).

For Mr. Galante, who worked through January 31, 2006, and retired February 1, 2006, the pension accrual shown in the table represents one additional month of service on the value of his lump sum pension distribution. The lump sum discount rate used was 4.25 percent and the rate for converting an age 60 pension to a present value was 5.75 percent.

Also shown in this column is the portion of annual earnings on each executive's principal balance under the Corporation's nonqualified supplemental savings plan that exceeds 120 percent of the applicable federal long-term interest rate, compounded monthly, as prescribed under Section 1274(d) of the Internal Revenue Code, as follows: $5,891 for Mr. Tillerson; $4,530 for Mr. Humphreys; $7,704 for Mr. McGill; $8,456 for Mr. Simon; $18,965 for Mr. Cramer; and $2,226 for Mr. Galante. The federal rate averaged approximately 6 percent during the year. Principal balances under the supplemental savings plan bear interest at the Citibank prime lending rate, which averaged approximately 8 percent during the year.

All Other Compensation

The following table breaks down the amounts included in the "All Other Compensation" column of the "Summary Compensation Table."

Name	Life Insurance ($)(a)	Savings Plan ($)(b)	Personal Security ($)(c)	Personal Use of Company		Club Memberships ($)(f)	Financial Planning ($)(g)	Tax Assistance ($)(h)	Total ($)
				Aircraft ($)(d)	Properties ($)(e)				
R.W. Tillerson	16,284	92,200	214,863	102,587	31,250	6,659	9,000	9,395	482,238
D.D. Humphreys	15,351	47,200	20,191	0	0	0	9,000	5,589	97,331
S.R. McGill	29,462	58,300	4,887	0	0	5,498	9,000	8,699	115,846
J.S. Simon	29,462	58,300	3,921	4,115	11,537	0	9,000	5,400	121,735
H.R. Cramer	15,893	48,575	3,005	0	0	6,087	9,000	10,588	93,148
E.G. Galante	1,582	5,367	610	0	0	1,083	12,400	8,090	29,132

(a) Life Insurance. The Company offers senior executives term life insurance or a Company-paid death benefit. Coverage under either option equals four times base salary until age 65, and a declining multiple thereafter until age 75, at which point the multiple remains at 2.5 times salary. For executives with life insurance coverage, the premium cost in any year depends on overall financial and mortality experience under the group policy. For executives electing the death benefit, there is no cash cost until the executive dies, as benefits are paid directly by the Company, not from the plan. The amount shown is based on Internal Revenue Service tables used to value the term cost of such coverage. This valuation is applied since the actual life insurance premium is a single payment for a large group of executives that does not represent the cost of insuring one specific individual and because several of the Named Executive Officers have elected the death benefit, the long-term cost of which is comparable to the insurance.

(b) Savings Plan. The amount shown is the value of Company-matching contributions under ExxonMobil's tax-qualified defined contribution (401(k)) plan and Company credits under the related nonqualified supplemental plan. The nonqualified supplemental plan provides all affected employees with the 6 percent Company credit to which they would otherwise be entitled as a matching contribution under the qualified plan but for limitations under the Internal Revenue Code. All affected employees participate in the nonqualified supplemental plan on the same basis. The value of the credits to the nonqualified supplemental plan is also disclosed in the "Nonqualified Deferred Compensation" table on page 40.

Table of Contents

Index to Financial Statements

(c) Personal Security. The Company provides security for all its employees as determined to be appropriate based on an assessment of risk. The assessment includes consideration of the employee's position and work location. We do not consider any such security costs to be personal benefits since these costs arise from the nature of the employee's employment by the Company; however, the SEC requires certain security costs to be reported as personal benefits. The reportable costs include the costs of residential security; security provided for commuting to/from work; and security provided during personal travel. Costs of security relating to travel for business purposes is not included. The amounts shown in the table on the previous page include the cost paid by the Company for security systems at executive residences; security services and personnel (at residences and/or during personal travel); car and personal security driver; and personal use of Company phones. Cars used primarily for commuting are valued based on the annualized lease cost of the car. For cars leased for security during personal travel, the amounts shown are the actual incremental rental costs. For security personnel employed by the Company, total employment costs are allocated based on good-faith estimates of the percentage of time the security employee spends in activities characterized by the SEC as personal, such as providing security for commuting and personal travel. For security contractors, the cost is the actual incremental cost of such contractors associated with the executive's personal time.

(d) Aircraft. For security reasons, the Board requires the Chairman and CEO to use Company aircraft for both business and personal travel. Although we consider these costs necessary business expenses rather than perquisites, per SEC guidance we report the incremental cost of aircraft usage for personal travel. Incremental cost for this purpose is based solely on direct operating costs (fuel, airport fees, incremental pilot costs, etc.) and does not include capital costs of the aircraft since the Company already incurs these capital costs for business purposes.

(e) Properties. The Company owns or leases various venues for the purpose of business entertainment, including boxes and season tickets to sporting events and recreational retreat properties. When these venues are not otherwise in use for business entertainment, the tickets and properties may be available for use by Company executives and other personnel. The table above shows the incremental cost incurred for any such personal use of these venues by the Named Executive Officers. Cost for this purpose is based solely on incremental operating costs (catering, transportation, incremental employee or contractor costs, etc.) and does not include annual or capital costs of these venues since the Company already incurs these costs for business purposes.

(f) Club Memberships. The Company has historically reimbursed country club memberships for senior executives. The value shown is based on the actual annual charge for the membership. The Company has discontinued the reimbursement of country club memberships in the future.

(g) Financial Planning. The Company provides financial planning services to senior executives, which includes tax preparation. This benefit is valued based on the actual charge for the services.

(h) Tax Assistance. The amount shown is the aggregate amount of payments made on the executive's behalf by the Corporation during the year for the payment of taxes related to club memberships and financial planning.

Total Remuneration

To achieve alignment with the interests of shareholders, it is the objective that 50 to 70 percent of the annual total remuneration of the Named Executive Officers, excluding Mr. Galante who retired February 1, 2006, be in the form of stock with long holding periods as described in the CD&A (based on grant date fair value as shown in the "Grants of Plan-Based Awards" table.) To further tie compensation to the performance of the business, about 15 to 20 percent of annual total remuneration is in the form of variable annual bonus awards, which are described on pages 25-26 of the CD&A. Salary represents less than 10 percent of annual total remuneration with pension accruals and other forms of compensation comprising the remainder.

Selected pages from the ExxonMobil proxy statement, regarding

2005 Executive Compensation

EXECUTIVE COMPENSATION TABLES

The following tables show the compensation of ExxonMobil's Chairman and the four other most highly paid executives in 2005. See the Compensation Committee Report beginning on page 14 for an explanation of our compensation philosophy.

Summary Compensation Table

		Annual Compensation			Long Term Compensation			
					Awards		Payouts	
Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compensation ($)(a)	Restricted Stock Award(s) ($)(b)	Shares Underlying Options (#)	LTIP Payouts ($)(c)	All Other Compensation ($)(d)
L. R. Raymond	2005	4,000,000	4,900,500	210,800	32,087,000	0	7,484,508	240,000
Chairman and CEO	2004	3,600,000	3,920,500	177,610	28,000,500	0	2,160,000	216,000
(e) (Resigned – 12/31/05)	2003	3,250,000	3,564,000	159,392	17,910,000	0	2,700,000	277,550
R. W. Tillerson	2005	1,166,667	1,250,000	72,269	8,751,000	0	1,726,025	72,100
President and	2004	958,333	1,000,000	101,238	6,720,120	0	440,010	59,550
Director(e)(f)	2003	691,667	726,000	20,502	3,832,740	0	399,990	43,500
E. G. Galante	2005	867,500	1,000,000	24,076	6,884,120	0	1,526,020	56,980
Senior Vice	2004	783,333	800,000	23,579	6,007,380	0	440,010	57,523
President (Retired – 2/1/06)	2003	691,667	726,000	131,418	3,832,740	0	399,990	51,136
S. R. McGill	2005	852,500	1,000,000	38,610	6,242,380	0	1,428,670	80,020
Senior Vice	2004	762,500	800,000	17,748	5,447,370	0	326,010	71,956
President	2003	725,000	628,700	20,717	2,629,188	0	407,490	68,468
J. S. Simon	2005	874,167	1,000,000	14,160	6,242,380	0	1,320,023(g)	124,093
Senior Vice	2004	810,417	691,400	15,750	4,622,628	0	326,010(g)	113,260
President and Director(e)	2003	740,000	628,700	13,963	2,629,188	0	407,490(g)	81,821

(a) This column shows the cost to the Company of club memberships, financial planning services, and tax assistance provided to the named executives, as well as the incremental cost of each executive's personal use of company aircraft and properties. The column shows the full amounts of these included items and does not rely on SEC rules that currently allow companies not to disclose the first $50,000 of perquisite costs. This column does not include the costs of personal security, but estimates of such amounts are disclosed in this footnote under "Personal Security."

General Perquisites. For Mr. Raymond, the totals include membership fees of $67,035 in 2005, $46,223 in 2004, and $42,301 in 2003, as well as tax assistance of $45,490 in 2005, $33,441 in 2004, and $29,880 in 2003. For Mr. Tillerson, the totals include personal use of company properties of $23,095 in 2004, as well as tax assistance of $9,129 in 2005, and $8,915 in 2004. For Mr. Galante, the totals include membership fees of $71,203 in 2003, as well as tax assistance of $47,107 in 2003.

Aircraft. For security reasons, the Board requires the Chairman and President to use company aircraft for both business and personal travel. Although we consider these costs a necessary business expense rather than a perquisite, in line with SEC guidance, the table includes the amounts attributable to the Chairman and President's personal aircraft usage. The incremental costs were $89,925 in 2005, $89,246 in 2004, and $79,711 in 2003 for Mr. Raymond; and $36,724 in 2005 and $54,559 in 2004 for Mr. Tillerson. Incremental cost for this purpose is based solely on incremental operating cost and does not include capital costs of the aircraft, since the Company would incur these capital costs anyway. Messrs. Raymond and Tillerson are taxed on the imputed income attributable to such personal aircraft use and do not receive tax assistance from the Company with respect to those amounts.

Personal Security. The Company provides security for all its employees as determined to be appropriate based on an assessment of risk. The assessment includes consideration of the employee's particular focus and circumstances, including position and work location. We do not consider any such security costs to be personal benefits since these costs arise from the nature of the employee's employment by the Company; however, we are disclosing estimates of such costs in this footnote in line with recent SEC guidance. This guidance suggests that issuers disclose certain personal security costs, including costs of residential security and security provided for commuting and personal travel, regardless of an executive's situation or the issuer's view of such costs. These costs for the Company include costs of: security systems at residences; security services and personnel (at residences and/or during personal travel); a car and personal security driver; and personal use of company phones.

Because of the Company's view that security is a business expense, we have not historically tracked the personal portion of these items separately. However, based on estimates of the personal component of mixed-purpose travel and certain other assumptions, we estimate that the aggregate incremental costs of providing these security services in 2005 to the named executive officers were approximately $550,000 for Mr. Raymond and $190,000 for Mr. Tillerson. The estimated amounts for the other named executive officers were less than $12,000 for each individual. These amounts are in addition to the personal aircraft costs described above in this footnote under "Aircraft" and included in the Summary Compensation Table.

Relocation Costs. The table does not include relocation costs for transferred executives since all affected employees participate in the Company's relocation programs on the same basis.

(b) The value shown is the number of restricted shares times the market price of ExxonMobil stock on the date of grant. Restricted shares granted in 2001 and prior years may not be sold until after retirement. Restricted shares granted in 2002 or later may not be sold (i) for half the shares, until five years after grant; and (ii) for the balance, until 10 years after grant or retirement, whichever occurs later. The values given do not reflect a reduction for the fact that the shares are subject to a lengthy restricted period and are subject to forfeiture in case of detrimental activity or early termination of employment. The executives receive the same cash dividends on restricted shares as holders of regular common stock, but cannot sell the shares during the restricted period. See page 16 for more details.

The following table shows the number of restricted shares granted by year from 2003 to 2005 and the total number of shares and dollar value of restricted stock held by the named executive officers as of December 31, 2005.

	Restricted Stock Awards by Year (#)			**Total Restricted Stock Held as of December 31, 2005**	
Name	**2003**	**2004**	**2005**	**(#)**	**($)**
L. R. Raymond	500,000	550,000	550,000	3,260,000	183,114,200
R. W. Tillerson	107,000	132,000	150,000	514,000	28,871,380
E. G. Galante	107,000	118,000	118,000	468,000	26,287,560
S. R. McGill	73,400	107,000	107,000	421,300	23,664,421
J. S. Simon	73,400	90,800	107,000	375,100	21,069,367

The Company's stock price on the date of grant was $35.82 in 2003; $50.91 in 2004; and $58.34 in 2005. The Company's stock price on December 30, 2005, the last trading day of the year, was $56.17.

The following table shows the aggregate cash dividends paid on all restricted shares held by the named executive officers by year from 2003 to 2005. As noted above, the executives receive the same cash dividends on restricted shares as holders of regular common stock.

	Cash Dividends Paid on Restricted Stock ($)		
Name	**2003**	**2004**	**2005**
L. R. Raymond	1,626,800	2,289,600	3,089,400
R. W. Tillerson	122,500	245,920	414,960
E. G. Galante	122,500	245,920	399,000
S. R. McGill	131,222	219,738	358,302
J. S. Simon	101,822	187,938	305,634

(c) Settlements of earnings bonus units. See page 15 for more details.

(d) This column shows the value of company credits under ExxonMobil's tax-qualified defined contribution (401(k)) plan and the related non-qualified supplemental plan. The non-qualified supplemental plan provides higher-paid employees with the full 6 percent, company-matching contribution to which they would otherwise be entitled under the qualified plan but for limitations under the tax code. All eligible employees participate in the non-qualified supplemental plan on the same basis. The non-qualified supplemental plan is unfunded and credits accrue interest at the prime rate. Total Company credits to defined contribution plans in 2005 were $240,000 for Mr. Raymond, $72,100 for Mr. Tillerson, $54,125 for Mr. Galante, $53,250 for Mr. McGill, and $54,550 for Mr. Simon.

This column also estimates the cost of executive life insurance: $2,855 for Mr. Galante, and $26,770 for Mr. McGill in 2005.

This amount also includes interest credits accrued on earnings bonus units for which payment was deferred: $69,543 for Mr. Simon in 2005.

(e) Mr. Raymond resigned as Chairman of the Board and CEO of ExxonMobil effective December 31, 2005, and he retired from the Company effective January 14, 2006. Mr. Tillerson was elected Chairman of the Board and CEO of ExxonMobil effective January 1, 2006. Mr. Simon was elected to the Board of Directors effective January 25, 2006.

(f) Mr. Tillerson's base salary in 2006 is $1,500,000.

(g) Under the original terms of these earnings bonus units, payment of the 2003 and prior grants was deferred until after retirement and accrued interest at the prime rate. However, in 2005, the Compensation Committee determined that all outstanding deferred incentive awards would be paid, together with accrued interest credits, in a single installment in August 2005. The Compensation Committee does not expect to grant such deferred awards in the future.

Selected pages from the ExxonMobil proxy statement, regarding

2004 Executive Compensation

EXECUTIVE COMPENSATION TABLES

The following tables show the compensation of ExxonMobil's Chairman, the four other most highly paid executives, and Mr. Longwell who retired at year-end. See the Compensation Committee Report beginning on page 13 for an explanation of our compensation philosophy.

Summary Compensation Table

		Annual Compensation			Long Term Compensation			
					Awards		Payouts	
Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compensation ($)(a)	Restricted Stock Award(s) ($)(b)	Shares Underlying Options (#)	LTIP Payouts ($)(c)	All Other Compensation ($)(d)
L. R. Raymond	2004	3,600,000	3,920,500	179,382	28,000,500	0	2,160,000	216,000
Chairman and CEO	2003	3,250,000	3,564,000	161,301	17,910,000	0	2,700,000	277,550
	2002	3,250,000	2,160,000	161,093	17,320,000	0	2,700,005	297,960
H. J. Longwell	2004	1,923,352	1,252,500	27,377	10,487,460	0	690,000	160,280
Executive Vice	2003	1,565,000	1,138,500	13,340	6,680,430	0	862,020	145,479
President and	2002	1,415,000	690,000	13,554	6,460,360	0	862,015	131,727
Director								
(Retired – 12/31/04)								
R. W. Tillerson	2004	958,333	1,000,000	102,073	6,720,120	0	440,010	59,550
President and	2003	691,667	726,000	20,502	3,832,740	0	399,990	43,500
Director	2002	562,500	440,000	38,166	3,706,480	0	300,025	35,750
E. G. Galante	2004	783,333	800,000	23,579	6,007,380	0	440,010	57,523
Senior Vice President	2003	691,667	726,000	131,418	3,832,740	0	399,990	51,136
	2002	562,500	440,000	12,750	3,706,480	0	300,025	41,960
S. R. McGill	2004	762,500	800,000	18,470	5,447,370	0	326,010	71,956
Senior Vice President	2003	725,000	628,700	21,953	2,629,188	0	407,490	68,468
	2002	660,000	326,000	23,759	2,421,336	0	372,515	62,509
J. S. Simon	2004	810,417	691,400	15,750	4,622,628	0	326,010(e)	113,260
Senior Vice President	2003	740,000	628,700	13,963	2,629,188	0	407,490(e)	81,821
	2002	675,000	326,000	13,863	2,421,336	0	340,010(e)	64,756

(a) This column shows the cost to the Company of club memberships, financial planning services, and tax assistance provided to the named executives, as well as the incremental cost of each executive's personal use of company aircraft, automobiles, and properties. SEC rules allow companies not to disclose the first $50,000 of perquisite costs, but ExxonMobil voluntarily discloses the full amount of those costs.

For Mr. Raymond, the totals include membership fees of $46,223 in 2004, $42,301 in 2003, and $49,228 in 2002, as well as tax assistance of $33,441 in 2004, $29,880 in 2003, and $37,897 in 2002. For Mr. Tillerson, the totals include personal use of company properties of $23,095 in 2004, as well as tax assistance of $8,915 in 2004. For Mr. Galante, the totals include membership fees of $71,203 in 2003, as well as tax assistance of $47,107 in 2003.

For security reasons, the Board requires the Chairman and President to use company aircraft for both business and personal travel. Although we consider these costs a necessary business expense rather than a perquisite, in line with SEC guidance, the table includes the amounts attributable to the Chairman and President's personal aircraft usage. The incremental costs were $89,246 in 2004, $79,711 in 2003, and $64,418 in 2002 for Mr. Raymond; and $54,559 in 2004 for Mr. Tillerson. Messrs. Raymond and Tillerson are taxed on the imputed income attributable to such personal aircraft use and do not receive tax assistance from the Company with respect to those amounts.

The Company provides security for its employees based on an assessment of risk. The assessment includes consideration of the employee's particular focus and circumstances, including position and work location. The table does not include costs of security because we do not consider such security costs to be a personal benefit.

The table also does not include relocation costs for transferred executives since all affected employees participate in the Company's relocation programs on the same basis.

(b) The value shown is the number of restricted shares times the market price of ExxonMobil stock on the day of grant. The table below shows the number of shares granted by year and the total number and value of restricted shares held by these executives as of December 31, 2004. Restricted shares granted in 2001 and prior years may not be sold until after retirement. Restricted shares granted in 2002 or later may not be sold (i) for half the shares, until five years after grant; and (ii) for the balance, until 10 years after grant or retirement, whichever occurs later. The values given do not reflect the transfer restrictions or the fact that, during the restricted period, the awards are subject to forfeiture in case of detrimental activity or early termination of employment. The executives receive the same cash dividends on restricted shares as holders of regular common stock, but cannot sell the shares during the restricted period. Grants in 2002 and prior years were made under the 1993 Incentive Program. Grants in 2003 and later were made under the 2003 Incentive Program. See page 15 for more details.

	Restricted Stock Award by Year (#)			Total Restricted Stock Held as of December 31, 2004	
Name	**2002**	**2003**	**2004**	**(#)**	**($)**
L. R. Raymond	500,000	500,000	550,000	2,710,000	138,914,600
H. J. Longwell	186,500	186,500	206,000	731,000	37,471,060
R. W. Tillerson	107,000	107,000	132,000	364,000	18,658,640
E. G. Galante	107,000	107,000	118,000	350,000	17,941,000
S. R. McGill	69,900	73,400	107,000	314,300	16,111,018
J. S. Simon	69,900	73,400	90,800	268,100	13,742,806

The stock price on date of grant was $34.64 in 2002; $35.82 in 2003; and $50.91 in 2004. The stock price on December 31, 2004, was $51.26.

(c) Settlements of earnings bonus units. See page 20 for more details.

(d) This column shows the value of company credits under ExxonMobil's tax-qualified defined contribution (401(k)) plan and the related non-qualified supplemental plan. The non-qualified supplemental plan provides higher-paid employees with the full 6-percent, company-matching contribution to which they would otherwise be entitled under the qualified plan but for limitations under the tax code. All eligible employees participate in the non-qualified supplemental plan on the same basis. The non-qualified supplemental plan is unfunded and credits accrue interest at the prime rate. Total defined contribution plan credits in 2004 were $216,000 for Mr. Raymond, $105,474 for Mr. Longwell, $59,550 for Mr. Tillerson, $48,875 for Mr. Galante, $47,800 for Mr. McGill, and $50,637 for Mr. Simon.

This column also includes the cost of executive life insurance: $54,806 for Mr. Longwell, $8,648 for Mr. Galante, and $24,156 for Mr. McGill.

For Mr. Simon, this amount also includes interest credits accrued on earnings bonus units for which payment is deferred until after retirement: $62,623 in 2004, $35,571 in 2003, and $22,256 in 2002.

(e) Under the terms of the award, payment is deferred until after retirement and accrues interest at the prime rate.

Selected pages from the ExxonMobil proxy statement, regarding

2003
Executive Compensation

integrated oil companies and other major U.S.-based corporations.

U.S. Income Tax Limits on Deductibility

U.S. income tax law limits the amount ExxonMobil can deduct for compensation paid to the CEO and the other four most highly paid executives. Performance-based compensation that meets Internal Revenue Service requirements is not subject to this limit. The short term awards and restricted stock grants described above are designed to meet these requirements so that ExxonMobil can continue to deduct the related expenses. Specifically, the shareholders have approved the material terms of performance goals for awards to the top executives. These material terms limit short term and long term awards to these executives to 0.2 and 0.5 percent of operating net income respectively. Actual award levels have been significantly less based on the factors and judgments described in the preceding sections of this report.

Summary

ExxonMobil continues to have an appropriate and competitive compensation program which has served the Company and shareholders well. The combination of base salary, short term bonuses, and the emphasis on long term incentives provides a balanced and stable foundation for strong and effective leadership going forward.

William R. Howell, Chair
Michael J. Boskin
James R. Houghton

Reatha Clark King
Henry A. McKinnell, Jr.

EXECUTIVE COMPENSATION TABLES

The following tables show the compensation of ExxonMobil's Chairman and the four other most highly paid executives. See the Compensation Committee Report beginning on page 17 for an explanation of our compensation philosophy.

Summary Compensation Table

		Annual Compensation			Long Term Compensation			
					Awards		Payouts	
Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compensation ($)(a)	Restricted Stock Award(s) ($)(b)	Options (#)	LTIP Payouts ($)(c)	All Other Compensation ($)(d)
L. R. Raymond	2003	3,250,000	3,564,000	81,590	17,910,000	0	2,700,000	277,550
Chairman and CEO	2002	3,250,000	2,160,000	96,675	17,320,000	0	2,700,005	297,960
	2001	2,850,000	2,700,000	77,941	7,424,000	1,050,000	1,355,130	261,288
H. J. Longwell	2003	1,565,000	1,138,500	4,500	6,680,430	0	862,020	145,479
Executive Vice President	2002	1,415,000	690,000	5,264	6,460,360	0	862,015	131,727
and Director	2001	1,250,000	863,000	6,590	742,400	500,000	443,520	116,300
E. G. Galante	2003	691,667	726,000	131,418	3,832,740	0	399,990	51,136
Senior Vice President	2002	562,500	440,000	5,250	3,706,480	0	300,025	41,960
	2001	444,583	400,000	4,680	371,200	200,000	120,150	33,283

R. W. Tillerson	2003	691,667	726,000	7,618	3,832,740	0	399,990	43,500
President and Director	2002	562,500	440,000	15,312	3,706,480	0	300,025	35,750
	2001	441,667	400,000	8,774	371,200	200,000	105,030	28,200
J. L. Thompson	2003	820,000	628,700	6,332	2,987,388	0	474,990	77,178
Vice President;	2002	760,000	380,000	10,497	2,888,976	0	412,500	71,677
President, ExxonMobil Exploration Company	2001	680,000	475,000	2,281	371,200	220,000	199,980	64,042

(a) Represents certain perquisites, including membership fees (Mr. Raymond: $42,301 (2003), $49,228 (2002), and $36,920 (2001); and Mr. Galante: $71,203 (2003)); and tax assistance (Mr. Raymond: $29,880 (2003), $37,897 (2002), and $31,598 (2001); and Mr. Galante: $47,107 (2003)). For security reasons, the Board requires the Chairman to use company aircraft for both business and personal travel. This table does not reflect amounts attributable to the Chairman's personal aircraft usage because we consider those costs a necessary business expense rather than a perquisite. The incremental cost for Mr. Raymond's personal use of company aircraft was $79,711 (2003), $64,418 (2002), and $36,596 (2001). Mr. Raymond is taxed on the imputed income attributable to such personal use and does not receive tax assistance from the Company with respect to those amounts.

(b) The value shown is the number of restricted shares times the market price of ExxonMobil stock on the day of grant. As of December 31, 2003, the total number and value of restricted shares held by these executives was: Mr. Raymond: 2,160,000 shares ($88,560,000); Mr. Longwell: 525,000 shares ($21,525,000); Mr. Galante: 232,000 shares ($9,512,000); Mr. Tillerson: 232,000 shares ($9,512,000); and Mr. Thompson: 238,800 shares ($9,790,800). Restricted shares granted in 2001 and prior years may not be sold until after retirement. Restricted shares granted in 2002 or later may not be sold (i) for half the shares, until five years after grant; and (ii) for the balance, until 10 years after grant or until after retirement, whichever occurs later. The values given do not reflect the transfer restrictions or the fact that, during the restricted period, the awards are subject to forfeiture in case of detrimental activity or early termination of employment. The executives receive the same cash dividends on restricted shares as holders of regular common stock, but cannot sell the shares during the restricted period. Grants in 2002 and prior years were made under the 1993 Incentive Program. Grants in 2003 were made under the 2003 Incentive Program. See page 19 for more details.

(c) Settlements of earnings bonus units. See page 22 for more details.

(d) 2003 values represent company credits and other allocations under defined contribution plans (Mr. Raymond: $195,000; Mr. Longwell: $95,900; Mr. Galante: $43,500; Mr. Tillerson: $43,500; and Mr. Thompson: $51,200); and costs of executive life insurance (Mr. Raymond: $82,550; Mr. Longwell: $49,579; Mr. Galante: $7,636; and Mr. Thompson: $25,978).

Aggregated Option/SAR Exercises in Last Fiscal Year and FY-End Option/SAR Values

Name	Number of Shares Underlying Options/SARs Exercised (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options/SARs at FY-End (#)		Value of Unexercised, In-the-Money Options/SARS at FY-End ($)*	
			Exercisable	Unexercisable	Exercisable	Unexercisable
L. R. Raymond	756,608	15,899,821	6,643,392	0	56,781,916	
H. J. Longwell	240,000	5,099,458	3,300,000	0	31,088,121	
E. G. Galante	20,000	419,500	632,080	0	3,832,371	
R. W. Tillerson	71,348	1,510,807	602,688	0	3,171,884	
J. L. Thompson	91,020	1,779,929	1,114,080	0	9,757,939	

* The difference between the option exercise price and the market price of ExxonMobil stock at year-end. The actual gain, if any, an executive realizes will depend on the market price of ExxonMobil stock at the time of exercise. "In-the-money" means the market price of the stock is greater than the exercise price of the option on the date specified.

Selected pages from the ExxonMobil proxy statement, regarding

2002
Executive Compensation

Summary

The Compensation Committee is responsible for seeing that ExxonMobil's compensation program serves the best interests of its shareholders. To help meet this responsibility, the Committee is guided by an independent analysis prepared by an outside consultant of the competitiveness of the total compensation of the CEO and other senior executives. This analysis is based on a survey of comparable positions at 13 other major corporations both within and outside the oil industry.

In the opinion of the Committee, ExxonMobil continues to have an appropriate and competitive compensation program, which has served the Company and shareholders well. The combination of base salary, short term bonuses, and emphasis on long term incentives provides a balanced and stable foundation for effective executive leadership.

William R. Howell, Chair
Michael J. Boskin
William T. Esrey

James R. Houghton
Reatha Clark King
Henry A. McKinnell, Jr.

EXECUTIVE COMPENSATION TABLES

The following tables show the compensation of ExxonMobil's Chairman and the five other most highly paid executives. See the Compensation Committee Report beginning on page 14 for an explanation of our compensation philosophy.

Summary Compensation Table

					Long Term Compensation			
		Annual Compensation			Awards		Payouts	
Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compensation ($)	Restricted Stock Award(s) ($)(b)	Options (#)	LTIP Payouts ($)(c)	All Other Compensation ($)(d)
L. R. Raymond	2002	3,250,000	2,160,000	103,884(a)	17,320,000	0	2,700,005	297,960
Chairman and CEO	2001	2,850,000	2,700,000	83,091	7,424,000	1,050,000	1,355,130	261,288
	2000	2,500,000	2,700,000	91,643	9,043,750	1,050,000	2,817,630	227,925
R. Dahan	2002	707,500	690,000	5,010	3,845,040	0	862,015	89,277
Executive Vice President	2001	1,250,000	863,000	5,370	0	500,000	443,520	116,300
and Director	2000	1,100,000	863,000	5,485	904,375	500,000	893,520	99,689
(Retired—06/30/02)								
H. J. Longwell	2002	1,415,000	690,000	5,264	6,460,360	0	862,015	131,727
Executive Vice President	2001	1,250,000	863,000	6,590	742,400	500,000	443,520	116,300
and Director	2000	1,100,000	863,000	5,485	904,375	500,000	893,520	99,689
K. T. Koonce	2002	780,000	380,000	10,452	2,888,976	0	412,500	73,510
Vice President;	2001	700,000	475,000	3,418	371,200	220,000	204,705	65,876
President, ExxonMobil	2000	620,000	412,500	1,181	452,188	180,000	425,205	67,087
Production Company								
J. L. Thompson	2002	760,000	380,000	10,497	2,888,976	0	412,500	71,677
Vice President;	2001	680,000	475,000	2,281	371,200	220,000	199,980	64,042
President, ExxonMobil	2000	600,000	412,500	3,674	452,188	180,000	415,080	64,937
Exploration Company								
D. S. Sanders	2002	700,000	350,000	4,389	2,459,440	0	407,550	66,176
Vice President;	2001	650,000	407,500	4,654	222,720	170,000	194,445	61,292
President, ExxonMobil	2000	585,000	407,500	3,510	271,313	150,000	382,095	63,324
Chemical Company								

(a) Represents certain perquisites, including membership fees of $49,228, and tax assistance of $37,897.

(b) The value shown is the number of restricted shares or restricted stock units times the market price of ExxonMobil stock on the day of grant. As of December 31, 2002, the total number and value of restricted shares and restricted stock units held by these executives was: Mr. Raymond: 1,660,000 shares ($58,000,400); Mr. Dahan: 243,000 ($8,490,420); Mr. Longwell: 338,500 ($11,827,190); Mr. Koonce: 153,400 ($5,359,796); Mr. Thompson: 155,400 ($5,429,676); and Mr. Sanders: 117,000 ($4,087,980). Restricted shares granted in 2001 and prior years may not be sold until after retirement. Restricted shares granted in 2002 may not be sold (i) for half the shares, until five years after grant, and (ii) for the balance, until 10 years after grant or until after retirement, whichever occurs later. The values given do not reflect the transfer restrictions or the fact that, during the restricted period, the awards are subject to forfeiture in case of detrimental activity or early termination of employment. The executives receive the same cash dividends on restricted shares as holders of regular common stock, but cannot sell the shares during the restricted period. Restricted shares in this table were granted under the 1993 Incentive Program. The restricted stock units were granted under an arrangement for selected annuitants. See page 15 for more details. Restricted stock units reflected in this table have substantially the same terms as restricted shares but are settled in cash.

(c) Settlements of earnings bonus units from prior year grants. See page 19 for more details.

(d) 2002 values represent company credits and other allocations under defined contribution plans (Mr. Raymond: $195,000; Mr. Dahan: $44,450; Mr. Longwell: $86,900; Mr. Koonce: $48,800; Mr. Thompson: $47,600; and Mr. Sanders: $44,000); and costs of executive life insurance (Mr. Raymond: $102,960; Mr. Dahan: $44,827; Mr. Longwell: $44,827; Mr. Koonce: $24,710; Mr. Thompson: $24,077; and Mr. Sanders: $22,176).

Aggregated Option/SAR Exercises in Last Fiscal Year and FY-End Option/SAR Values

Name	Number of Shares Underlying Options/SARs Exercised (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options/SARs at FY-End (#)		Value of Unexercised, In-the-Money Options/SARs at FY-End ($)*	
			Exercisable	Unexercisable	Exercisable	Unexercisable
L. R. Raymond	720,000	16,660,539	7,400,000	0	46,263,677	
R. Dahan	0	0	2,884,670	0	10,528,798	
H. J. Longwell	220,000	5,181,951	3,540,000	0	22,704,970	
K. T. Koonce	103,608	2,437,681	1,325,708	0	8,649,520	
J. L. Thompson	94,216	2,135,140	1,205,100	0	7,208,940	
D. S. Sanders	0	0	906,080	0	3,578,844	

* The difference between the option exercise price and the market price of ExxonMobil stock at year-end. The actual gain, if any, an executive realizes will depend on the market price of ExxonMobil stock at the time of exercise. "In-the-money" means the market price of the stock is greater than the exercise price of the option on the date specified.

Long Term Incentive Plans—Awards in Last Fiscal Year

Name	Number of Shares, Units or Other Rights	Performance or Other Period Until Maturation or Payout	Estimated Future Payouts Under Non-Stock Price-Based Plans
			Maximum ($)
L. R. Raymond	720,000	5 years maximum	2,160,000
R. Dahan	0		0
H. J. Longwell	230,000	5 years maximum	690,000
K. T. Koonce	126,670	5 years maximum	380,010
J. L. Thompson	126,670	5 years maximum	380,010
D. S. Sanders	116,670	5 years maximum	350,010

The awards shown above are earnings bonus units. Each earnings bonus unit entitles the executive to receive an amount equal to ExxonMobil's cumulative net income per common share as announced each quarter beginning after the grant. Payout occurs on the fifth anniversary of the grant or when the maximum settlement value of $3.00 per unit

Selected pages from the ExxonMobil proxy statement, regarding

2001 Executive Compensation

EXECUTIVE COMPENSATION TABLES

The following tables show the compensation of ExxonMobil's Chairman and the four other most highly paid executives. See the Board Compensation Committee (BCC) report beginning on page 12 for an explanation of our compensation philosophy. All share information listed below reflects the two-for-one stock split effective June 20, 2001.

Summary Compensation Table

		Annual Compensation			Long Term Compensation			
					Awards		Payouts	
Name and Principal Position	Year	Salary ($)	Bonus ($)(b)	Other Annual Compensation ($)	Restricted Stock Award(s) ($)(d)	Options (#)	LTIP Payouts ($)(f)	All Other Compensation ($)(g)
L. R. Raymond	2001	2,850,000	2,700,000	83,091(c)	7,424,000	1,050,000	1,355,130	261,288
Chairman and CEO	2000	2,500,000	2,700,000	91,643	9,043,750	1,050,000	2,817,630	227,925
	1999	2,110,417	13,900,000	222,571	8,356,250	850,000	0	128,547
R. Dahan	2001	1,250,000	863,000	5,370	0	500,000	443,520	116,300
Executive Vice President	2000	1,100,000	863,000	5,485	904,375	500,000	893,520	99,689
and Director	1999	953,333	2,640,000	5,484	835,625	400,000	0	75,136
H. J. Longwell	2001	1,250,000	863,000	6,590	742,400	500,000	443,520	116,300
Executive Vice President	2000	1,100,000	863,000	5,485	904,375	500,000	893,520	99,689
and Director	1999	953,333	2,640,000	5,484	835,625	400,000	0	75,136
E. A. Renna (a)	2001	1,250,000	863,000	12,806	0	500,000	714,185	75,000
Executive Vice President	2000	1,100,000	863,000	458,101	904,375	500,000	878,111	105,420
and Director	1999	828,750	2,880,500	0	835,625	703,632(e)	1,172,501	102,095
(Retired—1/31/02)								
K. T. Koonce	2001	700,000	475,000	3,418	371,200	220,000	204,705	65,876
Vice President;	2000	620,000	412,500	1,181	452,188	180,000	425,205	67,087
President, ExxonMobil	1999	546,667	515,000	0	417,813	140,000	0	60,378
Production Company								

(a) Mr. Renna became an executive of ExxonMobil when the merger closed in November 1999. In order to provide more complete and comparable information, we have included in this table compensation paid by Mobil before the merger.

(b) 1999 bonus includes regular annual bonus plus special merger bonus.

(c) Represents certain perquisites, including membership fees of $36,920, and tax assistance of $31,598.

(d) The value shown is the number of restricted shares times the market price of ExxonMobil stock on the day of grant. As of December 31, 2001, the total number and value of restricted shares held by these executives was: Mr. Raymond: 1,160,000 shares ($45,588,000); Mr. Dahan: 132,000 ($5,187,600); Mr. Longwell: 152,000 ($5,973,600); Mr. Renna: 40,000 ($1,572,000); and Mr. Koonce: 30,000 ($1,179,000). The values given do not reflect the fact that shares are restricted. The executives receive the same cash dividends on restricted shares as holders of regular common stock, but cannot sell the shares during the restricted period. See page 14 for more details on these shares, which we call Career Shares.

(e) Includes 1999 ExxonMobil grant plus Mobil grants of 303,632 shares to Mr. Renna.

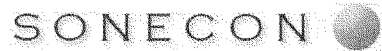
(f) Settlements of Earnings Bonus Units. See page 19 for more details.

(g) 2001 values represent company credits and other allocations under defined contribution plans (Mr. Raymond: $171,000; Mr. Dahan: $76,700; Mr. Longwell: $76,700; Mr. Renna: $75,000; and Mr. Koonce: $43,700); and costs of executive life insurance (Mr. Raymond: $90,288; Mr. Dahan: $39,600; Mr. Longwell: $39,600; and Mr. Koonce: $22,176).

The Financial Contribution of Oil and Natural Gas Company Investments To Major Public Pension Plans in Four States, 2005 – 2009

Robert J. Shapiro and Nam D. Pham

April 2011



The Financial Contribution of Oil and Natural Gas Company Investments To Major Public Employee Pension Plans in Four States, 2005 – 2009[1]

Executive Summary

This report examines the financial impact of investments in oil and natural gas companies on the overall performance of the two largest public employee pension funds in each of four states – Michigan, Missouri, Ohio and Pennsylvania.[2] The data show these investments sharply out-performed the funds' other assets. From 2005 to 2009, spanning both vigorous expansion and deep recession, the share of the funds' returns attributable to oil and natural gas investments was 2.5 times to 2.8 times greater than their share of those funds' assets.

Total Assets, Oil and Natural Gas Assets, and Returns on Those Assets, Two Largest Pension Funds in Four States, 2005 – 2009[3]

State	Total Assets (billions)	Oil and Natural Gas Assets (billions)	Oil and Natural Gas Assets As a Share of Total Assets	Returns from Oil and Gas Assets as a Share of All Returns	Ratio of Oil and Natural Gas Asset Returns to Their Share of Total Assets
MI	$52.8	$2.5	4.8%	12.2%	2.5 to 1
MO	$32.6	$1.1	3.3%	9.2%	2.8 to 1
OH	$138.3	$6.1	4.4%	11.6%	2.6 to 1
PA	$86.2	$2.9	3.4%	8.6%	2.5 to 1

- In all four states, the two largest public pension funds account for between 50% and 89% of the total membership and assets of all public employee pension programs in the state. The total membership of these programs ranges between 229,120 in Missouri to 1,378,179 in Ohio.
- The level and extent of these funds' investments in oil and natural gas vary across the four states from $1.1 billion and 3.3% of the total assets of the two largest plans in Missouri, to $6.1 billion and 4.4% of the assets of the two largest plans in Ohio.
- The oil and natural gas investments by Michigan's two largest public pension plans accounted for 4.8% of those funds' total assets while contributing 12.2% of those funds' total gains, for a ratio of 2.5 to 1. Similarly, the oil and natural gas investments by Missouri's two largest public pension plans accounted for 3.3% of those funds' total assets while contributing 9.2% of those funds' total gains, for a ratio of 2.8 to 1.
- The oil and natural gas investments by Ohio's two largest public pension plans accounted for 4.4% of those funds' total assets while contributing 11.6% of those funds' total gains, for a ratio of 2.6 to 1. The oil and natural gas investments by Pennsylvania's two largest public pension plans accounted for 3.4% of those funds' total assets while contributing 8.6% of those funds' total gains, for a ratio of 2.5 to 1.

---

[1] The authors wish to acknowledge research support from the American Petroleum Institute. The analysis and conclusions are solely those of the authors.

[2] We use "oil and gas company holdings" synonymously with "energy sector holdings" in this report, as oil and gas companies comprise 98 percent of the value of the S&P Energy Sector Index and the vast majority of energy sector holdings in the public employee pension funds examined here. The current S&P 500 Energy Sector Index is comprised of 60 percent integrated oil & gas companies; 18 percent oil & gas exploration and production enterprises; 14 percent oil and gas equipment and services firms; 3 percent oil and gas storage and transportation companies; 2 percent oil and gas drilling firms; and 1 percent oil & gas refining & marketing. Coal and consumable fuels account for the remaining 2 percent of the Index.

[3] Comprehensive Annual Financial Reports of different retirement systems. For details of sources, see footnotes for Tables MI-1, MO-1, OH-1, and PA-1.

The Financial Contribution of Oil and Natural Gas Company Investments To Major Public Pension Plans in Four States, 2005 – 2009[4]

Robert J. Shapiro and Nam D. Pham

I. Introduction and Summary of Results

This report examines the financial impact of investments in oil and natural gas companies to the overall performance of state public employee pension funds.[5] Many pension funds will face daunting challenges in meeting their future obligations. In this study, we analyze an aspect of a traditional investment approach for meeting this challenge by charting the impact over five years of investments in oil and natural gas companies by the two largest public pension funds in four states. We found that over the period from 2005 to 2009, spanning years of vigorous expansion and deep recession, the share of the funds' returns attributable to oil and natural gas assets was 2.5 times to 2.8 times greater than their share of those funds' assets. This analysis of public employee pension systems is an interim report. In coming months, we will expand it to 17 states and so cover a majority of the nation's state public employee pension members and assets.

The four states examined here are Michigan (MI), Missouri (MO), Ohio (OH), and Pennsylvania (PA). In each case, we analyze the portfolio and performance of the two largest public pension systems in the state, which in all cases are the pension program for public teachers and other public school employees, and the fund for state government employees. In all four states, these two funds account for between 50 percent and 89 percent of the total membership and total assets of all public employee pension programs in the state. The level and extent of these funds' investments in oil and natural gas, however, vary across the four states, from $1.1 billion and 3.3 percent of the total assets of the two largest plans in Missouri, to $6.1 billion and 4.4 percent of the assets of the two largest plans in Ohio. (Table 1, below)

Table 1. Membership, Assets, and Oil and Natural Gas Holdings of the Two Largest Pension Funds In Four States, Annual Average, 2005 – 2009[6]

State	Membership	Total Assets (Billions)	Oil and Natural Gas Assets (Billions)	Oil and Natural Gas Assets as a Share of Total Assets
MI	555,050	$52.8	$2.5	4.8%
MO	229,120	$32.6	$1.1	3.3%
OH	1,378,179	$138.3	$6.1	4.4%
PA	650,556	$86.2	$2.9	3.4%

[4] The authors wish to acknowledge research support from the American Petroleum Institute. The analysis and conclusions are solely those of the authors.

[5] We use "oil and gas company holdings" synonymously with "energy sector holdings" in this report, as oil and gas companies comprise 98 percent of the value of the S&P Energy Sector Index and the vast majority of energy sector holdings in the public employee pension funds examined here. The current S&P 500 Energy Sector Index is comprised of 60 percent integrated oil & gas companies; 18 percent oil & gas exploration and production enterprises; 14 percent oil and gas equipment and services firms; 3 percent oil and gas storage and transportation companies; 2 percent oil and gas drilling firms; and 1 percent oil & gas refining & marketing. Coal and consumable fuels account for the remaining 2 percent of the Index.

[6] Comprehensive Annual Financial Reports of different retirement systems. For details of sources, see footnotes for Tables MI-1, MO-1, OH-1, and PA-1.

Our analysis found that the public pension funds examined here achieved returns of 41 percent to 49 percent on their oil and natural gas investments over the five-year period, compared to returns of 10 percent to 17 percent for the same funds' non-oil and natural gas investments. (Table 2, below)

Table 2. Returns on All Assets and Oil and Natural Gas Assets of the Two Largest Pension Funds in Four States, 2005 – 2009[7]

State	Return on $1 Invested in US Oil and Natural Gas Stocks	Return on $1 Invested in All Other Assets	Returns from Oil and Natural Gas Investments as a Share of All Returns	Ratio of Oil and Natural Gas Assets' Share of All Returns and their Share of All Assets
MI	$1.49	$1.17	12.2%	2.5 to 1
MO	$1.41	$1.10	9.2%	2.8 to 1
OH	$1.48	$1.11	11.6%	2.6 to 1
PA	$1.48	$1.15	8.6%	2.5 to 1

Table 2, above, provides a summary measure of the relative performance of the oil and natural gas assets held by these public pension funds from 2005 to 2009, relative to other investments. This measure is the ratio of the oil and natural gas assets' share of all gains, relative to their share of all assets. We found that the share of these funds' gains attributable to their oil and natural gas investments was between 2.5 times and 2.8 times greater than these oil and natural gas investments' share of the funds' total assets. So, for example, the oil and natural gas investments by Michigan's two largest public pension plans accounted for 4.8 percent of those funds' total assets (Table 1, above) while contributing 12.2 percent of those funds' total gains, for a ratio of 2.5 to 1. (Table 2, above)

We also estimate the impact of oil and natural gas investments on the returns of all public employee pension programs in each state, using aggregate data collected by the Census Bureau. This analysis of state-wide public pension systems is not as complete as the prior analysis based on the two largest plans in each state. In particular, the Census Bureau has not issued 2009 data on statewide public pension systems. Since oil and natural gas shares declined in 2009, as did overall markets, the 2005-2008 data provide a less complete picture of the performance of oil and natural gas stocks, compared to other sectors and other classes of investments, over a business cycle.

With this caveat, the analysis of the Census Bureau data reinforces the more detailed examination of the major public pension funds in these states. (Table 3, below) Based on the statewide data, oil and natural gas investments significantly out-performed the rest of the portfolios of the statewide public employee pension systems of these four states, over the years 2005 to 2008.

[7] Comprehensive Annual Financial Report of different retirement systems, and authors' calculations. For details of sources, see Tables MI-2, MO-2, OH-2, PA-2..

Table 3. Cumulative Returns from All Assets and from Oil and Natural Gas Investments By Statewide Public Employee Pension Plans, Four States, 2005-2008[8]

State	Cumulative Returns from All Assets ($ million)	Cumulative Returns on Oil and Natural Gas Investments ($ million)	Oil and Natural Gas Assets As a Share of All Assets (Average)	Oil and Natural Gas Assets' Share of Returns from All Assets
MI	$28,446.4	$3,298.9	5.0%	11.6%
MO	$17,756.8	$1,355.9	2.8%	7.6%
OH	$63,770.1	$6,052.2	4.6%	9.5%
PA	$51,837.7	$3,101.1	3.1%	5.8%

These data show, for example, that the oil and natural gas assets of Michigan state public pension plans generated 11.6 percent of their returns while accounting for an average of 5.0 percent of their assets over the four years, a ratio of 2.3 to 1.0. The ratios for the other three states are 2.7 to 1.0 (MO), 2.1 to 1.0 (OH) and 1.9 to 1.0 (PA). In all cases, investments in oil and natural gas stocks widely outperformed the rest of these states' public pension system investments.

II. Methodology

This interim report estimates the financial impact of oil and gas company stocks to the returns achieved by the major public pension plans in Michigan, Missouri, Ohio and Pennsylvania over the five year period from 2005 to 2009. A subsequent report will examine 13 additional states. For each state, we selected the two largest state pension funds, covering public school employees and state employees. Across the four states analyzed here, these two public pension plans account for between 50 percent to 89 percent of the total assets and membership of all of the public pension plans in the states. The public pension plans within each state generally follow broadly similar investment strategies. Therefore, we also apply the energy holdings as a share of the total assets and annual returns of the two largest pension plans to the aggregate holdings of all of a state's public pension assets to estimate the financial contribution of oil and gas company stock prices to all public pension funds in that state.

For each state, we collected five years of investment data from the Comprehensive Annual Financial Reports (CAFRs) of the two largest public pension funds, including their total assets, asset allocations across classes of financial instruments, holdings by sector (including energy), and annual returns by financial class and sector. The asset allocations are reported for U.S. equities, international equities, fixed income securities, and other asset classes (cash, short-term instruments, real estate and alternative investments), in dollar amounts and as percentages of total assets. When a fund did not report its investments in the oil and natural gas sector (five of the eight funds in this interim report), we use the energy sector's share in the S&P 500 to estimate the pension fund's holdings of oil and natural gas stocks. For example, energy companies accounted for 9.3 percent of the value of the S&P 500 index in 2005, 9.8 percent in

[8] Comprehensive Annual Financial Report of different retirement systems, and authors' estimates. For details on sources, see Tables MI-4, MO-4, OH-4, and PA-4..

2006, 12.9 percent in 2007, 13.3 percent in 2008, and 11.5 percent in 2009.[9] We also use each fund's reported exposure to the oil and natural gas sector and the S&P 500 Energy Sector as a proxy for oil and gas company holdings and the return of the funds' oil and gas company holdings. The data reported by the funds does not include all individual company holdings, making it impossible to isolate oil and gas companies. However, the S&P 500 Energy Sector is comprised almost entirely of oil and gas companies, with oil and gas companies accounting for 98.1 percent of the current S&P Energy Sector.[10]

To estimate the holdings and returns for all public employee pension plans in a state, we use aggregate data reported by the U.S. Census Bureau on each state, including total assets, asset allocations, memberships, and benefits. Since the Census Bureau does not report oil and natural gas sector holdings by state, we apply the share of total holdings in oil and natural gas stocks for the state's largest pension plan in each year to the state-wide level. If a state's two largest public pension plans do not report their oil and natural gas sector holdings, we apply the share of oil and natural gas stocks in the S&P 500 and the returns of the S&P 500 Energy Sector.

In calculating the contribution of oil and natural gas stocks to each plan's assets and returns, we first estimate the plan's annual capital gains and losses based on its annual returns and assets. Next, we estimate the capital gains and losses of the plan's oil and natural gas sector holdings each year based on its oil and natural gas assets and the annual return of the S&P 500 Energy Sector Index. Finally, we use the fund's total capital gains and losses each year and the capital gains and losses of its oil and natural gas sector holdings to estimate the contribution of oil and natural gas sector companies to the fund's overall returns.

III. Michigan

The Two Largest Public Pension Plans

The various public employee retirement plans in Michigan publish annual data on their investment portfolios and performance. We collected those data for the fiscal years 2005-2009 for the State's two largest public employees retirement plans, the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS). Over this five-year period, these two plans had assets averaging $52.8 billion and an average of 555,050 members, including current retirees, current employees, and former or inactive employees. (Table MI-1, below) These two plans held oil and natural gas-sector investments averaging $2.54 billion or 4.8 percent of their total assets. The two plans represent more than 75 percent of all members and 60 percent of all assets of all Michigan public employee retirement plans.

[9] The domestic equity benchmark for public pension fund systems is typically based on a blend of several index benchmarks, such as the S&P 500, the Russell 3000, and the Wilshire 5000. Since the returns of financial indices are highly correlated over time, our results are not biased by our reliance on the S&P's index.

[10] The breakdown of the current S&P Energy Index: 60.3 percent integrated oil & gas companies; 17.75 percent oil & gas exploration and production; 14.11 percent oil and gas equipment and services; 2.66 percent oil and gas storage and transportation; 1.96 percent oil and gas drilling; and 1:29 percent oil & gas refining & marketing, Coal and consumable fuels account for 1.92 percent of the Index.

Table MI-1. Michigan's Two Largest Public Employee Retirement Plans: Members, Total Assets and Oil and Natural Gas Assets, Annual Average, 2005-2009[11]

	Total Members	Total Assets ($ billions)	Oil and Natural Gas Assets ($ billions)	Oil and Natural Gas Assets as a Share of All Assets
Total	**555,050**	**$52.831**	**$2.542**	**4.8%**
PSERS	470,328	$42.413	$2.041	4.8%
SERS	84,722	$10.408	$0.501	4.8%

The cumulative rate of return on the assets of these two large plans was about 23 percent for the five years, 2005 to 2009. (Table MI-2, below) By contrast, the S&P 500 Energy Sector produced a 49 percent return over the same period. The two plans, therefore, generated total gains of nearly $15 billion over this period, including $1.8 billion in gains from their investments in oil and natural gas stocks. As a result, oil and natural gas investments which represented 4.8 percent of the two plans' total assets contributed 12.15 percent of the two plans' total gains.

Table MI-2. Michigan's Two Largest Public Employee Retirement Plans: Rates of Return and Gains, Overall and from Oil and Natural Gas Investments, 2005-2009[12]

	Return on $1 invested in Plans	Return on $1 invested in Oil and Natural Gas Stocks	Return on $1 invested in Non-Oil and Natural Gas Investments	Total Gains by Plans (million)	Gains from Oil and Natural Gas Investments (million)	Gain from Oil and Natural Gas as Share of All Gains
Total	**$1.23**	**$1.49**	**$1.17**	**$14,983.8**	**$1,819.9**	**12.15%**
PSERS	$1.23	$1.49	$1.17	$12,034.9	$1,465.7	12.2%
SERS	$1.22	$1.49	$1.17	$2,948.9	$354.2	12.0%

All Michigan Public Employee Retirement Programs

To estimate the impact of oil and natural gas stocks on the returns on all Michigan public employee retirement programs, we use annual Census Bureau data on public employee retirement systems by state, including members, benefits, and the value and distribution of their assets. The available data cover 2005 to 2008, as the 2009 data have not yet been published. Since the returns on all investments and on oil and natural gas investments in particular fell sharply in 2009, the four years of aggregate data by state cannot be strictly compared to the five years of data on the large plans. The available data show, for example, that all public employee retirement plans in Michigan over this four-year period covered about 287,000 retirees and beneficiaries, 422,000 active employees, and nearly 33,000 inactive employees. The monthly benefit of the retirees under these public employee pension plans averaged $1,521. The Census Bureau data also show the allocation of total assets by asset-class for all public employee retirement plans in Michigan for the years 2005-2008. (Table MI-3, below)

[11] Comprehensive Annual Financial Report of Public Schools Employees Retirement Systems and State Employees Retirement System and authors' estimates.
[12] *Ibid.*

Table MI-3. All Michigan Public Employee Retirement Plans: Asset Allocations, 2005-2008[13]

Year	Total	US Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
As percentage of total assets						
2005	100.0%	45.3%	4.8%	9.3%	18.8%	26.6%
2006	100.0%	41.9%	4.6%	10.0%	17.0%	31.1%
2007	100.0%	40.1%	5.3%	9.3%	16.2%	34.4%
2008	100.0%	39.4%	5.1%	6.3%	18.0%	36.3%
In millions of US dollars						
2005	$74,130.0	$33,580.9	$3,558.2	$6,894.1	$13,936.4	$19,718.6
2006	$89,201.6	$37,375.5	$4,103.3	$8,920.2	$15,164.3	$27,741.7
2007	$105,084.2	$42,138.8	$5,569.5	$9,772.8	$17,023.6	$36,149.0
2008	$85,646.5	$33,744.7	$4,368.0	$5,395.7	$15,416.4	$31,089.7

With these data, we find that $1.00 invested in the Michigan public employees' retirement system in October 2004 grew to $1.31 in September 2008 (fiscal year ends September 30). Over this period, $1.00 invested in the S&P Energy Sector grew to $1.75. If the system had not held oil and natural gas stocks, $1.00 invested in 2005 would have grown to $1.22 in 2008.

Annual returns fluctuated widely over the four years, ranging from 17.2 percent to negative 12.3 percent for all assets and from 44.2 percent to negative 16.7 percent for oil and natural gas assets. (Table MI-4, below) Although these years are less representative without 2009, we estimate that oil and natural gas investments contributed $3.3 billion of the system's net $28.5 billion in returns over the period. Thus, oil and natural gas investments representing about 5 percent of total system holdings contributed 11.6 percent of their gains over this period.

Table MI-4. All Michigan Public Employee Retirement Plans, Returns and Gains for All Assets and for Oil and Natural Gas Investments, 2005-2008[14]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 in Oil & Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets But Invested in 2005	Capital Gains/ Losses for All Assets (million)	Capital Gains/ Losses of Oil and Natural Gas Investments (million)
10/2004			$1.00	$1.00	$1.00		
2005	12.8%	44.2%	$1.13	$1.44	$1.06	$9,488.6	$1,571.0
2006	12.8%	2.4%	$1.27	$1.48	$1.20	$11,417.8	$100.1
2007	17.2%	42.3%	$1.49	$2.10	$1.38	$18,074.5	$2,356.4
2008	-12.3%	-16.7%	$1.31	$1.75	$1.22	($10,534.5	($728.6)
Total						**$28,446.4**	**$3,298.9**

[13] U.S. Census' State & Local Government Employee Retirement Systems; Comprehensive Annual Financial Report; and authors' estimates.
[14] *Ibid.*

Background - Michigan

Michigan Public School Employees' Retirement System

The Michigan Public School Employees' Retirement System provides pension benefits for all public school employees in the State. The System's membership consists of retirees and beneficiaries; current employees, both vested and non-vested; and inactive employees entitled to benefits at some time. Membership averaged 470,300 over 2005-2009, and the monthly pension payments paid to its qualified retirees and beneficiaries averaged $1,538. (Table MI-5 below)

Table MI-5. Michigan Public School Employees' Retirement System, Membership Classes and Monthly Benefit Payments, 2005-2009[15]

Year	Retirees and Beneficiaries	Active Employees	Inactive Employees	Total	Average Monthly Benefit Payments
2005	151,706	316,151	16,806	484,663	$1,453
2006	157,163	305,445	15,739	478,347	$1,500
2007	162,844	295,984	14,999	473,827	$1,542
2008	167,265	278,642	14,312	460,219	$1,580
2009	171,922	268,208	14,454	454,584	$1,617
Average	**162,180**	**292,886**	**15,262**	**470,328**	**$1,538**

The public school pension fund's investments are well diversified. Domestic equities accounted for the largest share of assets averaging 44.5 percent of total holdings. Investments in energy companies, more than 98 percent in oil and gas companies, are estimated based on the System's asset allocation and benchmarks. Equity investments in oil and natural gas companies accounted for an average of 4.8 percent of total assets over this period. (Table MI-6)

Table MI-6. Michigan Public School Employees' Retirement System, Asset Allocation, 2005-2009[16]

Year	Total	US Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
			As percentage of total assets			
2005	100.0%	48.5%	4.8%	12.3%	16.4%	22.8%
2006	100.0%	48.4%	4.6%	12.2%	16.3%	23.1%
2007	100.0%	47.0%	5.3%	11.3%	16.4%	25.3%
2008	100.0%	42.1%	5.1%	8.9%	17.2%	31.8%
2009	100.0%	36.5%	4.1%	12.6%	18.8%	32.1%
			In millions of US dollars			
2005	$42,205.9	$20,469.9	$2,025.3	$5,191.3	$6,921.8	$9,623.0
2006	$43,145.6	$20,882.5	$1,984.7	$5,263.8	$7,032.7	$9,966.6
2007	$48,938.4	$23,001.0	$2,593.7	$5,530.0	$8,025.9	$12,381.4
2008	$41,339.6	$17,404.0	$2,108.3	$3,679.2	$7,110.4	$13,146.0
2009	$36,437.5	$13,299.7	$1,493.9	$4,591.1	$6,850.3	$11,696.4

[15] Michigan Public School Employees Retirement System, Comprehensive Annual Financial Report.
[16] *Ibid.*, S&P's; and authors' estimates.

Using the public school pension system's reported annual returns, we calculate that $1.00 invested in the System in October 2004 grew to $1.23 in September 2009 (the fiscal year ends on September 30). During this period, $1.00 invested in the S&P Energy Sector grew to $1.49. If the System had not invested in oil and natural gas stocks, $1.00 invested in 2004 would have grown to $1.17 in 2009.

We next estimate the annual capital gains and losses of the public school pension system's total assets and the portion invested in oil and natural gas stocks. Over this period, the System's net gains totaled more than $12 billion, including nearly $1.5 billion in net gains from investments in the oil and natural gas sector. The System's oil and natural gas investments, which accounted for 4.8 percent of its total assets, provided 12.2 percent of its total gains. (Table MI-7, below)

Table MI-7. Michigan Public School Employees' Retirement System, Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2009[17]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 of Oil and Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets Invested in 2005	Capital Gains/ Losses from All Assets (million)	Capital Gains/ Losses From Oil and Natural Gas Investments (million)
10/2004			$1.00	$1.00	$1.00		
2005	12.8%	44.2%	$1.13	$1.44	$1.06	$5,402.4	$894.4
2006	12.8%	2.4%	$1.27	$1.48	$1.20	$5,522.6	$48.4
2007	17.2%	42.3%	$1.49	$2.10	$1.38	$8,417.4	$1,097.4
2008	-12.3%	-16.7%	$1.31	$1.75	$1.22	$(5,084.8)	$(351.7)
2009	-6.1%	-14.9%	$1.23	$1.49	$1.17	$(2,222.7)	$(222.9)
Total						$12,034.9	$1,465.7

Michigan State Employees' Retirement System

The Michigan State Employees' Retirement System provides retirement, survivor and disability benefits to the state government employees. The System's membership includes retirees and beneficiaries currently receiving benefits, current employees including those vested and non-vested, and inactive employees entitled to benefits but not yet receiving them. The monthly pension payments to qualified retirees and beneficiaries averaged $1,427 per-month over this period. (Table MI-8)

[17] Michigan Public School Emloyees Retirement System, Comprehensive Annual Financial Report; S&P's; and authors' estimates.

Table MI-8. Michigan State Employees' Retirement System, Membership Classes and Monthly Benefit Payments, 2005-2009[18]

Year	Retirees and Beneficiaries	Active Employees	Inactive Employees	Total	Average Monthly Benefit Payments
2005	45,801	33,770	7,200	86,771	$1,360
2006	45,980	32,575	7,217	85,772	$1,394
2007	46,886	30,864	6,663	84,413	$1,425
2008	48,078	28,568	6,912	83,558	$1,460
2009	49,029	27,455	6,613	83,097	$1,497
Average	47,155	30,646	6,921	84,722	$1,427

The state employees' pension system's investments are well diversified across and within asset classes. Domestic equities accounted for the largest share of assets, averaging 44.6 percent of all assets. Investments in the energy sector, more than 98 percent in oil and gas companies, are calculated based on the System's asset allocation and benchmarks. Equity investments in oil and natural gas companies accounted for between 4.1 percent and 5.3 percent of the System's total assets over this period. (Table MI-9, below)

Table MI-9. Michigan State Employees' Retirement System, Asset Allocation, 2005-2009[19]

Year	Total	US Stocks: All Sectors	US Oil and Natural Gas tocks	International Equities	Fixed Income	Other Assets
As percentage of total assets						
2005	100.0%	48.9%	4.8%	11.8%	16.0%	23.3%
2006	100.0%	48.5%	4.6%	12.3%	16.3%	22.9%
2007	100.0%	47.3%	5.3%	11.5%	16.6%	24.6%
2008	100.0%	41.9%	5.1%	9.0%	16.7%	32.4%
2009	100.0%	36.6%	4.1%	12.9%	18.4%	32.1%
In millions of US dollars						
2005	$10,058.9	$4,918.8	$482.8	$1,187.0	$1,609.4	$2,343.7
2006	$10,835.9	$5,255.4	$498.5	$1,332.8	$1,766.3	$2,481.4
2007	$12,041.2	$5,695.5	$638.2	$1,384.7	$1,998.8	$2,962.1
2008	$10,183.3	$4,266.8	$519.3	$916.5	$1,700.6	$3,299.4
2009	$8,920.2	$3,264.8	$365.7	$1,150.7	$1,641.3	$2,863.4

Using the System's reported annual returns, we calculate that $1.00 invested in the System in October 2004 grew to $1.23 in September 2009 (the fiscal year ends on September 30). During this period, $1.00 invested in the S&P Energy Sector grew to $1.49. If the System had not invested in oil and natural gas stocks, $1.00 invested in 2005 would have grown to $1.17 in 2009. We next estimate the annual capital gains and losses of the System's assets and the portion invested in oil and natural gas stocks. Over this period, the System's net gains totaled nearly $3 billion, including $354 million in net gains from investments in the oil and natural gas

[18] Michigan State Employees Retirement System, Comprehensive Annual Financial Report.
[19] *Ibid.*, and S&P's; and authors' estimates.

sector. The oil and natural gas investments, which accounted for about 4.8 percent of the System's total assets provided 12.0 percent of the System's total gains. (Table MI-10)

Table MI-10. Michigan State Employees' Retirement System, Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2009[20]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 in Oil and Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets Invested in 2005	Capital Gains/ Losses from All Assets (million)	Capital Gains/ Losses from Oil and Natural Gas Investments (million)
10/2004			$1.00	$1.00	$1.00		
2005	12.8%	44.2%	$1.13	$1.44	$1.06	$1,287.5	$213.2
2006	12.8%	2.4%	$1.27	$1.48	$1.20	$1,387.0	$12.2
2007	17.2%	42.3%	$1.49	$2.10	$1.38	$2,071.1	$270.0
2008	-12.3%	-16.7%	$1.31	$1.75	$1.22	($1,252.5)	($86.6)
2009	-6.1%	-14.9%	$1.23	$1.49	$1.17	($544.1)	($54.6)
Total						$2,948.9	$354.2

IV. Missouri

The Two Largest Public Pension Plans

The retirement plans for public employees in Missouri (MO) publish annual data on their investment portfolios and performance. We collected data for FY 2005-2009 for the State's two largest public employees' pension plans, the Public School Retirement System of Missouri (PSRS) and the Missouri State Employees' Retirement System (MOSERS). Over this period, these plans had assets averaging $32.6 billion and an average of 230,000 members, including retirees, current employees and former employees. (Table MO-1, below) The plans held oil and natural gas investments averaging $1.1 billion, 3.3 percent of total assets. The two plans represent 52 percent of all members and 66 percent of all assets of Missouri public employee retirement plans.

Table MO-1. Missouri's Two Largest Public Employee Retirement Plans: Total Assets and Oil and Natural Gas Assets, 2005-2009[21]

	Total Members	Total Assets ($ billions)	Oil and Natural Gas Assets ($ billions)	Oil and Natural Gas Assets as Share of All Assets
Total or Average	229,120	$32.564	$1.089	3.3%
PSRS	128,445	$25.388	$0.856	3.4%
MOSERS	100,675	$7.176	$0.233	3.2%

[20] Michigan State Employees Retirement System, Comprehensive Annual Financial Report; S&P's; and authors' estimates.

[21] Comprehensive Annual Financial Report; S&P's; and authors' estimates.

The overall rate of return on the assets of these two large plans was about 16 percent over the five years, 2005-2009. (Table MO-2, below) In contrast, S&P 500 Energy Sector produced a 41 percent return over the same period. The two plans, therefore, generated total gains of more than $6 billion over this period, including nearly $600 million in gains from their investments in oil and natural gas stocks. As a result, oil and natural gas investments representing 3.3 percent of the two plans' total assets contributed 9.2 percent of their total gains.

Table MO-2. Missouri's Two Largest Public Employee Retirement Plans: Rates of Return and Gains Overall and from Oil and Natural Gas Investments, 2005-2009[22]

	Return on $1 invested in Plans	Return on $1 Invested in Oil and Natural Gas Stocks	Return on $1 of Non-Oil and Natural Gas Investments	Total Gains by Plans ($ million)	Gains from Oil and Natural Gas Investments ($ million)	Gain from Oil and Natural Gas as Share of All Gains
Total	$1.16	$1.41	$1.10	$6,180.4	$568.5	9.2%
PSRS	$1.08	$1.41	$1.03	$4,094.8	$417.2	10.2%
MOSERS	$1.23	$1.41	$1.18	$2,085.6	$151.3	7.3%

All Missouri Public Employee Retirement Programs

The Census Bureau issues annual aggregate data on public employee retirement systems by state, including the value and distribution of their assets. The data covering only 2005 – 2008 are currently available. Since the returns on all investments and oil and natural gas investments in particular fell sharply in 2009, the aggregate data by state cannot be strictly compared to the data on the large plans covering the additional year. The available data for 2005-2008 show, for example, that public employee retirement plans in Missouri covered some 133,000 retirees and beneficiaries, 273,000 active employees, and nearly 52,000 inactive employees. The monthly benefit of all retirees under these plans averaged $1,655. The Census Bureau data also provide the allocation of total assets by asset-class, 2005-2008. (Table MO-3, below)

Table MO-3. All Missouri Public Employee Retirement Plans: Asset Allocations, 2005-2008[23]

Year	Total	U.S. Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
As percentage of total assets						
2005	100.0%	34.2%	2.7%	15.8%	28.6%	21.4%
2006	100.0%	31.5%	2.8%	16.8%	32.3%	19.5%
2007	100.0%	33.0%	2.6%	20.6%	26.8%	19.6%
2008	100.0%	29.2%	3.2%	18.1%	23.9%	28.9%
In millions of US dollars						
2005	$49,739.0	$17,009.9	$1,360.8	$7,843.4	$14,226.2	$10,659.4
2006	$57,538.3	$18,126.2	$1,631.4	$9,641.4	$18,564.9	$11,205.8

[22] Comprehensive Annual Financial Report; S&P's; and authors' estimates.

[23] U.S. Census' State & Local Government Employee Retirement Systems; Comprehensive Annual Financial Report; S&P's; and authors' estimates.

2007	$60,235.4	$19,905.3	$1,592.4	$12,411.1	$16,117.4	$11,801.5
2008	$53,412.7	$15,572.1	$1,712.9	$9,647.2	$12,773.8	$15,419.6

We find that $1.00 invested in Missouri public employees' retirement plans in July 2004 grew to $1.33 in June 2008 (the fiscal year ends on June 30). During this period, $1.00 invested in the S&P Energy Sector grew to $2.48. If the Missouri plans had not invested in oil and natural gas stocks, $1.00 invested in 2005 would have grown to $1.25 in 2008. However, annual returns over these four years fluctuated widely, from 16.6 percent to negative 4.6 percent for all assets, and from 36.5 percent to 20.3 percent for oil and natural gas investments. (Table MO-4, below) Although these years are less representative without 2009 data, we estimate that oil and natural gas assets contributed $1.6 billion of the system's total $17.8 billion in returns over this period: Oil and natural gas investments representing 2.9 percent of total system holdings generated 8.9 percent of the gains over this period.

Table MO-4. All Missouri Public Employee Retirement Plans, Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2008[24]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 in Oil and Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets Invested in 2005	Capital Gains/ Losses from All Assets (million)	Capital Gains/ Losses from Oil and Natural Gas Investments (million)
7/2004			$1.00	$1.00	$1.00		
2005	9.2%	36.5%	$1.09	$1.37	$1.05	$4,576.0	$496.7
2006	9.8%	20.3%	$1.20	$1.64	$1.15	$5,638.8	$330.5
2007	16.6%	24.5%	$1.40	$2.04	$1.34	$9,999.1	$390.0
2008	-4.6%	21.4%	$1.33	$2.48	$1.25	$(2,457.0)	$366.4
Total						$17,756.8	$1,583.6

Background - Missouri

Public School Retirement System of Missouri (PSRS)

The Public School Retirement System of Missouri provides pension benefits covering all public school employees in the State. The System's membership includes retirees and beneficiaries receiving benefits, current employees including those vested and non-vested, and inactive employees entitled to benefits but not yet receiving them. (Table MO-5, below)

[24] U.S. Census' State & Local Government Employee Retirement Systems; Comprehensive Annual Financial Report; S&P's; and authors' estimates.

Table MO-5. Public School Retirement System of Missouri, Membership Classes and Monthly Benefit Payments, 2005-2009[25]

Year	Retirees and Beneficiaries	Active Employees	Inactive Employees	Total	Average Monthly Benefit Payments
2005	36,321	73,850	11,692	121,863	n/a
2006	38,110	75,539	11,753	125,402	n/a
2007	39,828	77,121	11,607	128,556	n/a
2008	41,738	78,436	11,580	131,754	n/a
2009	43,746	79,335	11,570	134,651	n/a
Average	39,949	76,856	11,640	128,445	n/a

The System's investments are well diversified. U.S. equities accounted for the largest share of assets. Investments in the oil and natural gas sector are estimated based on the System's asset allocation and benchmarks. Those oil and natural gas investments accounted for between 3.0 percent and 3.8 percent of the System's total assets over this period. (Table MO-6)

Table MO-6. Public School Retirement System of Missouri, Asset Allocation, 2005-2009[26]

Year	Total	US Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
As percentage of total assets						
2005	100.0%	39.7%	3.2%	17.6%	30.6%	12.1%
2006	100.0%	38.5%	3.5%	20.4%	27.9%	13.2%
2007	100.0%	36.9%	3.0%	21.6%	23.7%	17.8%
2008	100.0%	34.2%	3.8%	19.5%	20.9%	25.4%
2009	100.0%	32.3%	3.6%	17.8%	27.0%	22.9%
In millions of US dollars						
2005	$23,594.2	$9,366.9	$749.4	$4,152.6	$7,219.8	$2,854.9
2006	$25,458.9	$9,801.7	$882.2	$5,193.6	$7,103.0	$3,360.6
2007	$29,116.9	$10,744.1	$859.5	$6,289.2	$6,900.7	$5,182.8
2008	$27,268.4	$9,325.8	$1,025.8	$5,317.3	$5,699.1	$6,926.2
2009	$21,501.8	$6,945.1	$764.0	$3,827.3	$5,805.5	$4,923.9

Using the Missouri Public School Retirement System's reported returns, we find that $1.00 invested in July 2004 grew to $1.08 in June 2009 (the fiscal year ends on June 30). Over this period, $1.00 invested in the S&P Energy Sector grew to $1.41. If the System had not invested in oil and natural gas stocks, $1.00 invested in 2004 would have grown to $1.03 in 2009. (Table MO-7, below) We next estimate the capital gains and losses from this portfolio: The System's net gains totaled nearly $4.1 billion, including $553.5 million from oil and natural gas investments. These oil and natural gas investments, accounting for 3.4 percent of total assets, provided 13.5 percent of all gains.

[25] Public School Retirement System of Missouri.

[26] Public School Retirement System of Missouri, Comprehensive Annual Financial Report; S&P's; and authors' estimates.

Table MO-7. Public School Retirement System of Missouri, Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2009[27]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 in Oil and Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets Invested in 2005	Capital Gains/ Losses for All Assets (million)	Capital Gains/ Losses of Oil and Natural Gas Investments (million)
7/2004			$1.00	$1.00	$1.00		
2005	9.2%	36.5%	$1.09	$1.37	$1.05	$2,170.7	$273.5
2006	9.8%	20.3%	$1.20	$1.64	$1.14	$2,495.0	$178.7
2007	16.6%	24.5%	$1.40	$2.04	$1.34	$4,833.4	$210.5
2008	-4.6%	8.1%	$1.33	$2.48	$1.24	($1,254.3)	$83.1
2009	-19.3%	-43.0%	$1.08	$1.41	$1.03	($4,149.8)	($328.7)
Total						**$4,098.8**	**$553.5**

Missouri State Employees' Retirement System

The Missouri State Employees' Retirement System provides retirement, survivor and disability benefits retired employees of the state government. The System's membership, averaging almost 101,000 persons over this period, includes retirees and beneficiaries currently receiving benefits, current employees including those vested and non-vested, and inactive employees entitled to benefits but not yet receiving them. The pension payments to qualified retirees and beneficiaries averaged $940 per-month over this period. (Table MO-8)

Table MO-8. Missouri State Employees' Retirement System, Membership Classes and Monthly Benefit Payments, 2005-2009[28]

Year	Retirees and Beneficiaries	Active Employees	Inactive Employees	Total	Average Monthly Benefit Payments
2005	26,117	56,336	14,789	97,242	$941
2006	27,450	54,887	15,829	98,166	$914
2007	29,129	54,763	16,578	100,470	$945
2008	30,572	54,943	17,123	102,638	$926
2009	32,100	55,454	17,304	104,858	$973
Average	**29,074**	**55,277**	**16,325**	**100,675**	**$940**

The System's investments are well diversified across and within asset classes. Domestic equities and fixed-income instruments were the two largest classes of investment assets. Investments in the energy sector, more than 98 percent in oil and gas companies, were calculated

[27] Public School Retirement System of Missouri, Comprehensive Annual Financial Report; S&P's; and authors' estimates.
[28] Missouri State Employees' Retirement System, Comprehensive Annual Financial Report.

based on the System's asset allocation and benchmarks. Equity investments in oil and natural gas companies accounted for an average of 3.2 percent of the System's total assets over this period. (Table MO-9, below)

Table MO-9. Missouri State Employees' Retirement System, Asset Allocation, 2005-2009[29]

Year	Total	US Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
As percentage of total assets						
2005	100.0%	28.7%	2.7%	21.4%	29.4%	20.5%
2006	100.0%	28.5%	2.8%	23.1%	28.9%	19.5%
2007	100.0%	27.7%	3.6%	23.9%	28.1%	20.3%
2008	100.0%	28.3%	3.8%	15.9%	30.9%	24.9%
2009	100.0%	28.3%	3.3%	19.2%	29.4%	23.1%
In millions of US dollars						
2005	$6,475.6	$1,855.9	$172.6	$1,386.4	$1,903.3	$1,330.1
2006	$7,037.9	$2,005.8	$196.6	$1,625.8	$2,034.0	$1,372.4
2007	$8,123.3	$2,250.1	$290.3	$1,941.5	$2,282.6	$1,649.0
2008	$8,020.0	$2,269.7	$301.9	$1,275.2	$2,478.2	$1,997.0
2009	$6,225.0	$1,761.7	$202.6	$1,195.2	$1,830.2	$1,438.0

Using the System's reported annual returns, we calculate that $1.00 invested in the Missouri State Employees' Retirement System in July 2004 grew to $1.23 in June 2009 (the fiscal year ends on June 30). During this period, $1.00 invested in the S&P Energy Sector grew to $1.41. If the System had not invested in oil and natural gas stocks, $1.00 invested in 2004 would have grown to $1.18 in 2009.

We next estimate the annual capital gains and losses from the System's total assets and from the portion invested in oil and natural gas stocks. Over this period, the System's net gains totaled nearly $2.1 billion, including nearly $151 million in net gains from investments in the oil and natural gas sector. The oil and natural gas investments, which accounted for 3.2 percent of the System's total assets, provided 7.3 percent of its total gains. (Table MO-10, below)

---

[29] Missouri State Employees' Retirement System, Comprehensive Annual Financial Report; S&P's; and authors' estimates.

Table MO-10. Missouri State Employees' Retirement System, Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2009[30]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 of Oil and Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets Invested in 2005	Capital Gains/ Losses from All Assets (million)	Capital Gains/ Losses from Oil and Natural Gas Investments (million)
7/2004			$1.00	$1.00	$1.00		
2005	12.6%	36.5%	$1.13	$1.37	$1.09	$817.9	$63.0
2006	11.5%	20.3%	$1.26	$1.64	$1.21	$809.4	$39.8
2007	18.7%	24.5%	$1.49	$2.04	$1.42	$1,519.1	$71.1
2008	1.6%	8.1%	$1.51	$2.48	$1.42	$128.3	$64.6
2009	-19.1%	-43.0%	$1.23	$1.41	$1.18	($1,189.0)	($87.2)
Total						$2,085.6	$151.3

V. Ohio

The Two Largest Public Pension Plans

The various retirement plans for public employees in Ohio (OH) publish annual data on their investment portfolios and performance. We collected those data for the two largest Ohio public employees' retirement plans, the State Teachers Retirement System of Ohio (STRS) and the Ohio Public Employees Retirement System (OPERS) for the five years 2005-2009.[31] Over this period, the two plans had combined asserts of some $138 billion and an average of nearly 1.4 million members, including retirees, current employees, and former or inactive employees. (Table OH-1, below) The two plans held investments of $6.1 billion in the oil and natural gas sector, or 4.4 percent of their total assets. The two plans represent more than 89 percent of all members and 80 percent of all assets of all Ohio public employee retirement plans.

Table OH-1. Ohio's Two Largest Public Employee Retirement Plans: Total Assets and Oil and Natural Gas Assets, Annual Average, 2005-2009[32]

	Total Members	Total Assets ($ billions)	Oil and Natural Gas Assets ($ billions)	Oil and Natural Gas Assets as Share of All Assets
Total or Average	1,378,179	$138.3	$6.1	4.4%
STRS	469,382	$66.8	$2.8	4.2%
OPERS	908,797	$71.5	$3.3	4.6%

[30] *Ibid.*.
[31] The two plans use different fiscal years;so, we set aside the difference to calculate their memberships and assets.
[32] Comprehensive Annual Financial Report; S&P's; and authors' estimates.

The rate of return on all of the assets of these two large plans averaged 18 percent for the five years 2005 - 2009. (Table OH-2, below) By contrast, the S&P 500 Energy Sector produced around 48 percent return over the same period.[33] The two plans, therefore, generated total gains of nearly $41 billion over this period, including more than $4.6 billion in gains from their investments in oil and natural gas stocks. As a result, oil and natural gas investments representing 4.4 percent of the two plans' total assets contributed 11.6 percent of the two plans' gains.

Table OH-2. Ohio's Two Largest Public Employee Retirement Plans: Rates of Return and Gains Overall and from Oil and Natural Gas Investments, 2005-2009[34]

	Return on $1 invested in Plans	Return on $1 invested in Oil and Natural Gas Stocks	Return on $1 invested in Non-Oil and Natural Gas Investments	Total Gains by Plans ($ million)	Gains from Oil and Natural Gas Investments ($ million)	Gain from Oil and Natural Gas as Share of All Gains
Total	**$1.18**	**$1.48**	**$1.11**	**$40,730.2**	**$4,643.0**	**11.6%**
STRS	$1.15	$1.41	$1.09	$17,659.9	$2,200.8	12.5%
OPERS	$1.20	$1.54	$1.13	$23,070.3	$2,442.2	10.6%

All Ohio Public Employee Retirement Programs

The Census Bureau issues aggregate annual data on Ohio public employee retirement plans, including members, benefits, and the value and distribution of their assets. Once again, only the data for 2005–2008 are available at this time; and since the returns on all investments and on oil and natural gas investments in particular fell sharply in 2009, these aggregate data covering four years cannot be strictly compared to the five years of data on the State's two largest plans. The data which are available show that all public employee retirement plans in Ohio covered 370,000 retirees and beneficiaries, 700,000 active employees, and nearly 500,000 inactive employees. The monthly benefit of all Ohio retirees under public employee pension plans averaged $1,906. The Census Bureau also provides data on the allocation of these plans' assets by asset-class, again covering 2005-2008. (Table OH-3)

[33] Since STRS fiscal year ends on June 30 and OPERS' fiscal year ends on December 31, the returns of the S&P 500 Oil and natural gas Sector associated to the funds' fiscal year are different. For example, from July 1, 2009 to December 31, 2009, the S&P 500 Oil and natural gas Sector increased by 14.8 percent.

[34] Comprehensive Annual Financial Report; S&P's; and authors' estimates.

Table OH-3. All Ohio Public Employee Retirement Plans: Assets and Asset Allocations, 2005-2008[35]

Year	Total	U.S. Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
As percentage of total assets						
2005	100.0%	42.9%	4.0%	19.4%	21.1%	16.6%
2006	100.0%	41.9%	4.1%	20.5%	22.7%	14.8%
2007	100.0%	40.9%	5.3%	21.9%	22.1%	15.1%
2008	100.0%	37.4%	5.0%	22.2%	22.0%	18.5%
In millions of US dollars						
2005	136,819.2	$58,741.1	$5,462.9	$26,490.6	$28,897.6	$22,689.8
2006	149,874.3	$62,865.8	$6,160.9	$30,705.3	$34,089.2	$22,214.0
2007	166,416.4	$68,054.5	$8,779.0	$36,483.0	$36,784.1	$25,094.8
2008	163,876.4	$61,246.6	$8,145.8	$36,304.4	$35,975.8	$30,349.6

We calculate that $1.00 invested in Ohio public employee retirement plans in July 2004 grew to $1.46 in June 2008 (fiscal year ends on June 30). Over this period, $1.00 invested in the S&P Energy Sector grew to $2.48. If the Ohio plans had not invested in oil and natural gas stocks, $1.00 invested in 2005 would have grown to $1.34 in 2008.

Over these four years, annual returns fluctuated widely, ranging from 21.2 percent to negative 5.4 percent for all assets, and from 36.5 percent to 20.3 percent for oil and natural gas investments. (Table OH-4, below) Although these years are less representative without the 2009 data, we estimate that the System's oil and natural gas investments produced about $7.1 billion of the System's total returns of $63.8 billion. Therefore, oil and natural gas investments representing 4.6 percent of the System's total holdings contributed 11.2 percent of its gains over this period.

Table OH-4. All Ohio Public Employee Retirement Plans, Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2008[36]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 Invested in Oil and Natural Gas in 2005	Return on $1 of All Assets but Oil and Natural Gas Invested in 2005	Capital Gains/ Losses for all Assets (million)	Capital Gains/Losses of Oil and Natural Gas Investments (million)
1/2005			$1.00	$1.00	$1.00		
2005	12.3%	36.5%	$1.12	$1.36	$1.07	16,760.4	1,993.9
2006	13.7%	20.3%	$1.28	$1.64	$1.21	20,577.7	1,248.5
2007	21.2%	24.5%	$1.55	$2.04	$1.44	35,346.8	2,150.3

[35] U.S. Census' State & Local Government Employee Retirement Systems; and authors' estimates; Comprehensive Annual Financial Report; S&P's; and authors' estimates.
[36] *Ibid.*.

2008	-5.4%	21.4%	$1.46	$2.48	$1.34	(8,914.9)	1,742.2
Total						**$63,770.1**	**$7,135.0**

Background - Ohio

The State Teachers Retirement System of Ohio

The State Teachers Retirement System of Ohio provides pension benefits for all Ohio public school employees. Its membership consists of retirees and beneficiaries receiving benefits, current vested and non-vested employees, and inactive employees entitled to benefits but not yet receiving them. Membership averaged 470,000 persons over this period. (Table OH-5, below) The monthly pension payments paid to qualified retirees and beneficiaries averaged $2,793.

Table OH-5. State Teachers Retirement System of Ohio, Membership Classes and Monthly Benefit Payments, 2005-2009[37]

Year	Retirees and Beneficiaries	Active Employees	Inactive Employees	Total	Average Monthly Benefit Payments
2005	115,395	n/a	n/a	454,692	$2,557
2006	119,184	n/a	n/a	461,624	$2,677
2007	122,934	n/a	n/a	469,475	$2,796
2008	126,506	n/a	n/a	476,287	$2,911
2009	129,659	n/a	n/a	486,333	$3,025
Average	**122,736**	**n/a**	**n/a**	**469,682**	**$2,793**

The assets of the Ohio State Teachers Retirement System are well diversified. Domestic equities accounted for the largest share of assets, representing 37.3 percent of total assets over this period. Investments in oil and natural gas companies are estimated based on the System's asset allocation and benchmarks. These oil and natural gas investments averaged 4.2 percent of total assets, ranging from 3.7 percent to 4.9 percent. (Table OH-6, below)

Table OH-6. State Teachers Retirement System of Ohio, Asset Allocation, 2005-2009[38]

Year	Total	US Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
As percentage of total assets						
2005	100.0%	44.2%	4.1%	19.1%	21.5%	15.2%
2006	100.0%	39.3%	3.9%	22.8%	22.7%	15.3%
2007	100.0%	37.8%	4.9%	22.3%	22.0%	17.9%
2008	100.0%	33.4%	4.4%	21.5%	20.9%	24.3%
2009	100.0%	31.8%	3.7%	21.0%	20.1%	27.2%
In millions of US dollars						
2005	$59,636.8	$26,359.5	$2,451.4	$11,390.6	$12,821.9	$9,064.8
2006	$67,388.0	$26,483.5	$2,595.4	$15,330.8	$15,297.1	$10,276.7
2007	$79,599.2	$30,104.4	$3,883.5	$17,774.5	$17,511.8	$14,208.5
2008	$72,590.3	$24,208.9	$3,219.8	$15,606.9	$15,171.4	$17,603.1

[37] State Teachers Retirement System of Ohio, Comprehensive Annual Financial Report.
[38] *Ibid.*, S&P's; and authors' estimates.

2009	$54,736.5	$17,378.8	$1,998.6	$11,467.3	$11,002.0	$14,888.3

Using the System's reported annual returns, we calculate that $1.00 invested in the Ohio State Teachers Retirement System in July 2004 grew to $1.15 in June 2009 (the fiscal year ends on June 30). During this period, $1.00 invested in the S&P Energy Sector grew to $1.41. If the System had not invested in oil and natural gas stocks, $1.00 invested in 2004 would have grown to $1.09 in 2009.

We next estimate the annual capital gains and losses of the Ohio teachers' retirement system's total assets and the portion invested in oil and natural gas stocks. Over this period, the System's net gains totaled nearly $17.7 billion, including $2.2 billion in net gains from investments in the oil and natural gas sector. The oil and natural gas investments, then, accounted for 4.2 percent of the System's total assets but provided 12.5 percent of the System's total gains. (Table OH-7, below)

Table OH-7. State Teachers Retirement of Ohio,
Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2009[39]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 in Oil and Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets Invested in 2005	Capital Gains/ Losses from All Assets (million)	Capital Gains/ Losses from Oil and Natural Gas Investments (million)
7/2004			$1.00	$1.00	$1.00		
2005	12.3%	36.5%	$1.12	$1.36	$1.07	$7,305.5	$894.8
2006	13.7%	20.3%	$1.28	$1.64	$1.21	$9,252.4	$526.0
2007	21.2%	24.5%	$1.55	$2.04	$1.45	$16,906.9	$951.2
2008	-5.4%	8.1%	$1.46	$2.48	$1.35	$(3,948.9)	$688.7
2009	-21.7%	-43.0%	$1.15	$1.41	$1.09	$(11,855.9)	$(859.8)
Total						**$17,659.9**	**$2,200.8**

Ohio Public Employees Retirement System

The Ohio Public Employees Retirement System provides retirement, survivor and disability benefits to Ohio state government employees. The System's membership averaged almost 909,000 people, including retirees and beneficiaries currently receiving benefits, current employees including those vested and non-vested, and inactive employees entitled to benefits but not yet receiving them. (Table OH-8, below) The monthly pension payments to qualified retirees and beneficiaries averaged $1,621 over this period.

[39] State Teachers Retirement System of Ohio, Comprehensive Annual Financial Report; S&P's; and authors' estimates.

Table OH-8. Ohio Public Employees Retirement System, Membership Classes and Monthly Benefit Payments, 2005-2009[40]

Year	Retirees and Beneficiaries	Active Employees	Inactive Employees	Total	Average Monthly Benefit Payments
2005	151,758	381,413	327,864	861,035	$1,471
2006	156,747	381,464	346,697	884,908	$1,545
2007	161,348	382,177	364,823	908,348	$1,620
2008	166,516	374,002	395,445	935,963	$1,696
2009	171,955	365,229	416,548	953,732	$1,774
Average	**161,665**	**376,857**	**370,275**	**908,797**	**$1,621**

The System's investments are well diversified across and within asset classes. Domestic equities are for the largest class of assets, averaging nearly 41 percent of the portfolio over this period. Investments in the oil and natural gas sector, calculated based on the System's asset allocation and benchmarks, accounted for an average of 4.6 percent of its total assets over this period. (Table OH-9, below)

Table OH-9. Ohio Public Employees Retirement System, Asset Allocation, 2005-2009[41]

Year	Total	US Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
			As percentage of total assets			
2005	100.0%	44.1%	4.1%	20.2%	26.5%	9.2%
2006	100.0%	43.8%	4.3%	20.3%	27.7%	8.2%
2007	100.0%	40.7%	5.3%	21.4%	28.2%	9.7%
2008	100.0%	36.1%	4.8%	18.8%	31.4%	13.6%
2009	100.0%	40.0%	4.6%	22.7%	25.7%	11.6%
			In millions of US dollars			
2005	$69,191.9	$30,513.6	$2,837.8	$13,976.8	$18,335.8	$6,365.7
2006	$77,848.7	$34,089.9	$3,340.8	$15,795.5	$21,564.1	$6,399.2
2007	$83,032.1	$33,794.1	$4,359.4	$17,777.2	$23,390.1	$8,070.7
2008	$58,718.8	$21,215.1	$2,821.6	$11,056.8	$18,437.7	$8,009.3
2009	$68,562.1	$27,452.2	$3,157.0	$15,556.7	$17,599.9	$7,953.2

Using the annual returns reported by the Ohio Public Employees Retirement System, we calculate that $1.00 invested by the System in January 2005 grew to $1.20 in December 2009 (the fiscal year ends on December 31). Over this period, $1.00 invested in the S&P Energy Sector grew to $1.54. If the System had not invested in oil and natural gas stocks, $1.00 invested in 2005 would have grown to $1.13 in 2009. We next estimate the annual capital gains and losses of this System's total assets and of the portion invested in oil and natural gas stocks. Over this period, the System's net gains totaled $23 billion, including nearly $2.44 billion in net gains from investments in the oil and natural gas sector. The oil and natural gas assets of the Ohio

[40] Ohio Public Employees Retirement System, Comprehensive Annual Financial Report.
[41] *Ibid.*, S&P's; and authors' estimates.

State Employees Retirement System, which accounted for 4.6 percent of its total assets, provided 10.6 percent of the System's total gains. (Table OH-10, below)

Table OH-10. Ohio Public Employees Retirement System, Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2009[42]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 in Oil and Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets Invested in 2005	Capital Gains/ Losses from All Assets (million)	Capital Gains/ Losses from Oil and Natural Gas Investments (million)
1/2005			$1.00	$1.00	$1.00		
2005	9.0%	33.3%	$1.09	$1.33	$1.04	$6,227.3	$946.0
2006	14.7%	22.2%	$1.25	$1.63	$1.18	$11,443.8	$742.1
2007	8.5%	32.4%	$1.36	$2.16	$1.24	$7,082.6	$1,411.7
2008	-26.9%	-35.9%	$0.99	$1.38	$0.93	($15,807.1)	($1,013.9)
2009	20.6%	11.3%	$1.20	$1.54	$1.13	$14,123.8	$356.3
Total						$23,070.3	$2,442.2

VI. Pennsylvania

The Two Largest Public Pension Plans

The retirement plans for public employees in Pennsylvania (PA) publish annual data on their investment portfolios and performance. We collected those data for the two largest Pennsylvania public employees' retirement plans, the Pennsylvania Public School Employees' Retirement System (PSERS) and the Pennsylvania State Employees' Retirement System (SERS), for the years 2005-2009.[43] Over this period, the two plans had combined assets averaging $86.4 billion and membership averaging than 650,000 people. (Table PA-1, below) The plans held $2.9 billion in oil and natural gas stocks, 3.4 percent of total assets. The two plans account for over 67 percent of members and 74 percent of all assets of all Pennsylvania public pension plans.

Table PA-1. Pennsylvania's Two Largest Public Employee Retirement Plans: Total Assets and Oil and Natural Gas Assets, 2005-2009[44]

	Total Members	Total Assets (billions)	Oil and Natural Gas Assets (billions)	Oil and Natural Gas Assets as Share of All Assets
Total	650,556	$86.244	$2.934	3.4%
PSERS	434,618	$57.444	$2.097	3.5%
SERS	215,938	$28.800	$0.837	2.8%

[42] Ohio Public Employees Retirement System, Comprehensive Annual Financial Report; S&P's; and authors' estimates.
[43] The two plans use different fiscal years; so we set aside the difference to calculate their memberships and assets.
[44] Comprehensive Annual Financial Report; S&P's; and authors' estimates.

The overall rate of return on the assets of these two large plans averaged 18 percent for the five years 2005 - 2009. (Table PA-2, below) In contrast, S&P 500 Energy Sector produced around 48 percent return over the same period.[45] The two plans, therefore, generated total gains of more than $29 billion over this period, including $2.5 billion in gains from their investments in oil and natural gas stocks. As a result, oil and natural gas investments representing around 3.4 percent of the two plans' total assets contributed 8.6 percent of the two plans' gains.

Table PA-2. Pennsylvania's Two Largest Public Employee Retirement Plans: Rates of Return and Gains Overall and from Oil and Natural Gas Investments, 2005-2009[46]

	Return on $1 invested in Plans	Return on $1 invested in Oil and Natural Gas Stocks	Return on $1 invested in Non-Oil and Natural Gas Investments	Total Gains by Plans ($ million)	Gains from Oil and Natural Gas Investments ($ million)	Gain from Oil and Natural Gas as Share of All Gains
Total	**$1.18**	**$1.48**	**$1.15**	**$29,378.8**	**$2,519.3**	**8.6%**
PSERS	$1.14	$1.41	$1.12	$18,156.1	$1,764.0	9.7%
SERS	$1.22	$1.54	$1.19	$11,222.7	$755.3	6.7%

All Pennsylvania Public Employee Retirement Programs

The Census Bureau issues annual aggregate data on all Pennsylvania public employee retirement systems, including members, benefits, and assets. Once again, only the data covering 2005 – 2008 are available; and since the returns on all investments and oil and natural gas stocks in particular fell sharply in 2009, these four years of aggregate data cannot be strictly compared to the five years of data on Pennsylvania's two largest public employee pension plans. However, the available data show that all public employee retirement plans in Pennsylvania covered some 350,000 retirees and beneficiaries, 500,000 active employees, and nearly 100,000 inactive employees. The monthly benefit of all retirees under the State's public employee pension plans averaged $1,760. The Census Bureau data also show the allocation of the plans' investments by asset-class for the years 2005-2008. (Table PA-3, below) The largest asset class held by Pennsylvania public employee pension plans was "other assets," including cash, short-term instruments, real estate and alternative investments, and which averaged 32.5 percent of the plans' total assets over the four years. U.S. equities accounted for an average of 28.2 percent of total assets, and U.S. oil and natural gas stocks represented an average of 3.1 percent of their total portfolios.

[45] Since the PSERS fiscal year ends on June 30 and the SERS fiscal year ends on December 31, the returns of the S&P 500 Oil and natural gas Sector associated with the funds' fiscal years are different. For example, from July 1, 2009 and December 31, 2009, the S&P 500 Oil and natural gas Sector increased by 14.8 percent.

[46] Comprehensive Annual Financial Report; S&P's; and authors' estimates.

Table PA-3. All Pennsylvania Public Employee Retirement Plans: Assets and Asset Allocations, 2005-2008[47]

Year	Total	U.S. Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
As percentage of total assets						
2005	100.0%	32.3%	3.0%	18.1%	20.7%	28.9%
2006	100.0%	33.5%	3.3%	19.8%	20.3%	26.3%
2007	100.0%	31.8%	4.1%	23.9%	18.7%	25.6%
2008	100.0%	15.0%	2.0%	19.1%	16.5%	49.3%
In millions of US dollars						
2005	$95,165.4	$30,778.9	$2,862.4	$17,210.5	$19,718.4	$27,457.6
2006	$103,314.2	$34,588.2	$3,389.6	$20,500.0	$21,005.4	$27,220.6
2007	$118,310.0	$37,639.5	$4,855.5	$28,271.4	$22,081.5	$30,317.5
2008	$117,173.2	$17,564.9	$2,336.1	$22,437.8	$19,363.5	$57,806.9

We calculate that $1.00 invested by Pennsylvania public employee pension plans in July 2004 grew to $1.55 in July 2009 (the fiscal year ends on June 30). Over this period, $1.00 invested in the S&P Energy Sector grew to $2.48. If these plans had not invested in oil and natural gas stocks, $1.00 invested in 2005 would have grown to $1.50 in 2008.

Over the four years, the annual returns on the System's assets fluctuated widely, from 22.9 percent to negative 2.8 percent for all assets, and from 20.3 percent to 36.5 percent for oil and natural gas assets. (Table PA-4, below) Although these years are less representative without 2009, oil and natural gas investments by the State's public employee pension plans represented $3.4 billion of their total $52 billion in returns for this period. Oil and natural gas assets representing 3.1 percent of total holdings contributed 6.6 percent of the gains over this period.

Table PA-4. All Pennsylvania Public Employee Retirement Plans, Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2008[48]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 in Oil and Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets Invested in 2005	Capital Gains/ Losses from All Assets (million)	Capital Gains/ Losses from Oil and Natural Gas Investments (million)
7/2004			$1.00	$1.00	$1.00		
2005	12.9%	36.5%	$1.13	$1.36	$1.09	$12,247.8	$1,044.8
2006	15.3%	20.3%	$1.30	$1.64	$1.25	$15,765.7	$686.9
2007	22.9%	24.5%	$1.60	$2.04	$1.52	$27,128.5	$1,189.3

[47] U.S. Census' State & Local Government Employee Retirement Systems; Comprehensive Annual Financial Report; S&P's; and authors' estimates.
[48] *Ibid.*

2008	-2.8%	21.4%	$1.55	$2.48	$1.50	($3,304.3)	$499.7
Total						$51,837.7	$3,420.7

Background - Pennsylvania

Pennsylvania Public School Employees' Retirement System

The Pennsylvania Public School Employees' Retirement System provides pension benefits for all public school employees in the State. The System's membership, as in all states, consists of retirees and beneficiaries receiving benefits, current vested and non-vested employees, and inactive employees not yet receiving benefits due them. However, the System reports only current retirees and beneficiaries and current employees. The monthly pension paid to qualified retirees and beneficiaries averaged $1,749 over the 2005-2009 period. (Table PA-5)

Table PA-5. Pennsylvania Public School Employees' Retirement System, Membership Classes and Monthly Benefit Payments, 2005-2009[49]

Year	Retirees and Beneficiaries	Active Employees	Inactive Employees	Total	Average Monthly Benefit Payments
2005	156,519	255,465	n/a	n/a	$1,612
2006	161,813	263,350	n/a	n/a	$1,686
2007	168,026	264,023	n/a	n/a	$1,748
2008	173,540	272,690	n/a	n/a	$1,830
2009	177,963	279,701	n/a	n/a	$1,871
Average	167,572	267,046	n/a	n/a	$1,749

The Public School Employees' Retirement System's investments are well diversified. Domestic equities' share declined in recent years, while "Other Assets" increased. (Table PA-6, below) Investments in oil and natural gas stocks are estimated based on the System's asset allocation and benchmarks. U.S. equity investments in oil and natural gas companies accounted for an average of 3.5 percent of the System's total assets over this period.

Table PA-6. Pennsylvania Public School Employees' Retirement System, Assets and Asset Allocation, 2005-2009[50]

Year	Total	US Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
As percentage of total assets						
2005	100.0%	42.5%	4.0%	19.0%	22.0%	16.5%
2006	100.0%	39.6%	3.9%	22.8%	21.7%	15.9%
2007	100.0%	32.0%	4.1%	28.3%	20.5%	19.2%
2008	100.0%	29.1%	3.9%	22.5%	20.8%	27.6%
2009	100.0%	16.4%	1.9%	16.0%	28.6%	39.0%
In millions of US dollars						
2005	$52,739.7	$22,414.4	$2,084.5	$10,020.5	$11,602.7	$8,702.1
2006	$58,719.3	$23,252.8	$2,278.8	$13,388.0	$12,742.1	$9,336.4

[49] Pennsylvania Public School Employees' Retirement System, Comprehensive Annual Financial Report.
[50] *Ibid.*, S&P's; and authors' estimates.

2007	$68,526.5	$21,928.5	$2,828.8	$19,393.0	$14,047.9	$13,157.1
2008	$63,892.2	$18,592.6	$2,472.8	$14,375.7	$13,289.6	$17,634.3
2009	$43,343.9	$7,108.4	$817.5	$6,935.0	$12,396.4	$16,904.1

Using the annual returns reported by the Pennsylvania Public School Employees Retirement System, we calculate that $1.00 invested in July 2004 grew to $1.14 in June 2009 (the fiscal year ends on June 30). Over this period, $1.00 invested in the S&P Energy Sector grew to $1.41. If the System had not invested in oil and natural gas stocks, $1.00 invested in 2004 would have grown to $1.12 in 2009.

We next estimate the System's annual capital gains and losses on all of its assets and on the portion invested in oil and natural gas stocks. Over this period, the System's net gains totaled nearly $18.2 billion, including nearly $2.1 billion in net gains from investments in the oil and natural gas sector. The oil and natural gas investments which accounted for 3.5 percent of the System's total assets provided 11.5 percent of its total gains. (Table PA-7, below)

Table PA-7. Pennsylvania Public School Employees' Retirement System, Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2009[51]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 in Oil and Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets Invested in 2005	Capital Gains/ Losses from All Assets (million)	Capital Gains/ Losses from Oil and Natural Gas Investments (million)
7/2004			$1.00	$1.00	$1.00		
2005	12.9%	36.5%	$1.13	$1.36	$1.07	$6,787.6	$760.8
2006	15.3%	20.3%	$1.30	$1.64	$1.24	$8,960.6	$461.8
2007	22.9%	24.5%	$1.60	$2.04	$1.51	$15,713.1	$692.9
2008	-2.8%	8.1%	$1.55	$2.48	$1.46	$(1,801.8)	$528.9
2009	-26.5%	-43.0%	$1.14	$1.41	$1.12	$(11,503.5)	$(351.7)
Total						**$18,156.1**	**$2,092.7**

Pennsylvania State Employees' Retirement System

The Pennsylvania State Employees' Retirement System provides retirement, survivor and disability benefits to employees of the state government. The System's membership includes retirees and beneficiaries currently receiving benefits, current employees including those vested and non-vested, and inactive employees entitled to benefits but not yet receiving them. Once again, the system does not provide data on inactive employees. Monthly pension payments to qualified retirees and beneficiaries averaged $1,418 over this period. (Table PA-8, below)

[51] Pennsylvania Public School Employees' Retirement System, Comprehensive Annual Financial Report; S&P's; and authors' estimates.

Table PA-8. Pennsylvania State Employees' Retirement System, Membership Classes and Monthly Benefit Payments, 2005-2009[52]

Year	Retirees and Beneficiaries	Active Employees	Inactive Employees	Total	Average Monthly Benefit Payments
2005	101,179	109,981	n/a	n/a	$1,318
2006	102,060	110,972	n/a	n/a	$1,352
2007	107,130	109,610	n/a	n/a	$1,437
2008	108,146	110,866	n/a	n/a	$1,470
2009	109,639	110,107	n/a	n/a	$1,510
Average	105,631	110,307	n/a	n/a	$1,418

The State Employees' Retirement System's investments are diversified across and within asset classes. Here, too, investments in equities – domestic oil and natural gas and international -- all declined in recent years; while investments in "other assets" rose sharply. (Table PA-9, below) The System's investments in the oil and natural gas sector are calculated based on the asset allocation and benchmarks. Equity investments in oil and natural gas companies accounted for between 1.7 percent and 3.5 percent of the System's total assets over this period, and averaged 2.8 percent of those assets.

Table PA-9. Pennsylvania State Employees' Retirement System, Assets and Asset Allocation, 2005-2009[53]

Year	Total	US Stocks: All Sectors	US Oil and Natural Gas Stocks	International Equities	Fixed Income	Other Assets
As percentage of total assets						
2005	100.0%	34.0%	3.2%	20.9%	16.0%	29.1%
2006	100.0%	35.8%	3.5%	20.5%	15.3%	28.4%
2007	100.0%	24.9%	3.2%	20.3%	13.8%	41.0%
2008	100.0%	19.6%	2.6%	13.7%	14.3%	52.4%
2009	100.0%	14.5%	1.7%	10.9%	11.8%	62.8%
In millions of US dollars						
2005	$28,805.2	$9,793.8	$910.8	$6,020.3	$4,608.8	$8,382.3
2006	$32,100.5	$11,492.0	$1,126.2	$6,580.6	$4,911.4	$9,116.5
2007	$35,542.2	$8,850.0	$1,141.7	$7,215.1	$4,904.8	$14,572.3
2008	$22,907.4	$4,489.9	$597.2	$3,138.3	$3,275.8	$12,003.5
2009	$24,644.2	$3,573.4	$410.9	$2,686.2	$2,908.0	$15,476.6

Using the annual returns reported by the State Employees' Retirement System, we calculate that $1.00 invested by the System in January 2005 grew to $1.22 in December 2009 (the fiscal year ends on December 31). Over this period, $1.00 invested in the S&P Energy Sector grew to $1.54. If the System had not invested in any oil and natural gas stocks, $1.00 invested in 2005 would have grown to $1.19 in 2009.

---

[52] Pennsylvania State Employees' Retirement System, Comprehensive Annual Financial Report.
[53] *Ibid.*, S&P's; and authors' estimates.

We next estimate the annual capital gains and losses of the System's total assets and of the portion invested in oil and natural gas stocks. Over this period, the System's net gains totaled more than $11.2 billion, including about $755 million in net gains from its investments in oil and natural gas companies. These oil and natural gas investments accounted for 2.8 percent of the System's total assets and provided 6.7 percent of the System's total gains. (Table PA-10)

Table PA-10. Pennsylvania State Employees' Retirement System, Returns and Gains for All Assets and Oil and Natural Gas Investments, 2005-2009[54]

Year	Annual Return on All Assets	Annual Return on Oil and Natural Gas Stocks	Return on $1 of All Assets Invested in 2005	Return on $1 in Oil and Natural Gas Assets Invested in 2005	Return on $1 of Non-Oil and Natural Gas Assets Invested in 2005	Capital Gains/ Losses from All Assets (million)	Capital Gains/ Losses from Oil and Natural Gas Investments (million)
1/2005			$1.00	$1.00	$1.00		
2005	14.5%	33.3%	$1.15	$1.33	$1.10	$4,176.8	$303.6
2006	16.4%	22.2%	$1.33	$1.63	$1.28	$5,264.5	$250.2
2007	17.2%	32.4%	$1.56	$2.16	$1.49	$6,113.3	$369.7
2008	-28.7%	-35.9%	$1.11	$1.38	$1.08	($6,574.4)	($214.6)
2009	9.1%	11.3%	$1.22	$1.54	$1.19	$2,242.6	$46.4
Total						$11,222.7	$755.3

[54] Pennsylvania State Employees' Retirement System, Comprehensive Annual Financial Report; and authors' estimates; S&P's; and authors' estimates.

References

Michigan Public School Employees Retirement System, Comprehensive Annual Financial Report

Michigan State Employees Retirement System, Comprehensive Annual Financial Report

Missouri Public School Employees Retirement System, Comprehensive Annual Financial Report

Missouri State Employees Retirement System, Comprehensive Annual Financial Report

Ohio State Teachers Retirement System, Comprehensive Annual Financial Report

Ohio Public Employees Retirement System, Comprehensive Annual Financial Report

Pennsylvania Public School Employees' Retirement System, Comprehensive Annual Financial Report.

Pennsylvania State Employees' Retirement System, Comprehensive Annual Financial Report.

Standard & Poor's.

U.S. Census' State & Local Government Employee Retirement Systems

About the Authors

Robert J. Shapiro is the chairman and co-founder of Sonecon, LLC, a private firm that advises U.S. and foreign businesses, governments and non-profit organizations on market conditions and economic policy. He is also a Senior Fellow of the Georgetown University School of Business, advisor to the International Monetary Fund, director of the Globalization Initiative at NDN, chair of the U.S. Climate Task Force, co-chair of the America Task Force Argentina, and a director of the Ax:son-Johnson Foundation in Sweden. From 1997 to 2001, Dr. Shapiro was Under Secretary of Commerce for Economic Affairs. In that post, he directed economic policy for the Commerce Department and oversaw the nation's major statistical agencies, including the Census Bureau before and during the 2000 decennial census. Prior to that, he was co-founder and Vice President of the Progressive Policy Institute, Legislative Director for Senator Daniel P. Moynihan, and Associate Editor of *U.S. News & World Report*. Dr. Shapiro also served as the principal economic advisor to Governor Bill Clinton in his 1991-1992 presidential campaign, and senior economic advisor to Vice President Albert Gore, Jr. and Senator John Kerry in their presidential campaigns. In the 2008 campaign, he advised the campaign and transition of Barack Obama. Dr. Shapiro has been a Fellow of Harvard University, the Brookings Institution, and the National Bureau of Economic Research. He holds a Ph.D. and M.A. from Harvard University, a M.Sc. from the London School of Economics and Political Science, and an A.B. from the University of Chicago. He is widely published in scholarly and popular journals, and his most recent book is *Futurecast: How Superpowers, Populations and Globalization Will Change the Way You Live and Work*, St. Martins Press: 2008.

Nam D. Pham is the managing partner of NDP Group, LLC, an economics consulting firm that specializes in assessing complex issues in finance, industrial organization and international trade. Clients of NDP Group include U.S. and foreign corporations, financial institutions, federal and local governments, trade associations and multi-national organizations. Prior to founding NDP Group in 2000, Dr. Pham was Vice President at Scudder Kemper Investments in Boston, where he was responsible for research, asset allocations and currency hedges for Scudder's global and international bond funds. Before that, he was Chief Economist of the Asia Region for Standard & Poor's DRI in Boston. Dr. Pham's has more than twenty years of experience in multinational organizations and government agencies in Washington D.C. This tenure includes posts as an economist at the World Bank and a consultant to the Department of Commerce and the Federal Trade Commission. In addition, Dr. Pham has been an adjunct professor at the George Washington University, where he has taught undergraduate and graduate courses in monetary economics, international trade and finance, macroeconomics and microeconomics. Dr. Pham earned a Ph.D. in economics from the George Washington University with concentrations in international trade and finance, economic development and applied microeconomics, a M.A. from Georgetown University and a B.A. from the University of Maryland.

Senate Committee on Finance Hearing
"Oil and Gas Tax Incentives and Rising Energy Prices"
May 12th, 2011
Questions for Mr. Rex Tillerson

The questions below were received after ExxonMobil's initial response to the Committee's post-hearing questions, which was filed on June 20, 2011. To an extent, a number of the questions raised below by Senators Cornyn and Coburn are similar to those raised earlier by other members of the committee. As appropriate, several answers provided below are similar to those previously provided to the committee. In some cases, our answers therefore provide a cross-reference to previously-answered questions.

Questions for the Record

From Senator Cornyn

TAXING DOMESTIC PRODUCERS

1. Has there been any analysis done on how these domestic energy tax hikes would impact the 9.2 million jobs that the industry supports? Can you tell the Committee what it will mean to your operations?

   A: First, to be clear and to re-emphasize several points made during the hearing in May, the tax provisions proposed by Senator Menendez and others under consideration are not special industry incentives or subsidies; they are the same as or similar to deductions and credits that are generally available under the tax code to all industries. Removing them for a select few U.S. oil and gas companies would therefore be discriminatory and punitive. Further, it would unwisely and arbitrarily jeopardize sustained domestic energy investment, threaten existing jobs, and significantly harm the potential for significant new jobs for American workers.

   Wood Mackenzie recently reviewed the impacts of proposed increased taxes on U.S. oil and gas upstream operations by $5 billion per annum starting in 2011. Their work can be found online at http://api.org/policy/tax/recentstudiesandresearch/upload/SOAE_Wood_Mackenzie_Access_vs_Taxes.pdf. Wood Mackenzie concluded that:

   - Increased taxes will make a number of currently economic fields un-economic, resulting in estimated direct job losses of 50,000 and an additional 120,000 indirect job losses in 2014;

   - Further, the forecast of potential direct and indirect job losses are 50,000 in 2020 and nearly 30,000 in 2025.[1]

[1] Wood Mackenzie, *Energy Policy at a Crossroads: An Assessment of the Impacts of Increased Access Versus Higher Taxes on U.S. Oil and Natural Gas Production, Government Revenue, and Employment*, revised June 24, 2011, p. 21

The same study showed that opening up access to energy resources that have been kept off-limits could create up to 530,000 new jobs by the year 2025.

Beyond projected job losses caused by increasing industry taxes, Wood Mackenzie also found potential reductions in government revenue:

- Government tax increases will result in a short-term and unsustained $3 billion increase in annual government revenue in the period 2011 to 2015. However, starting in 2016 government revenue will be reduced (compared to the base case) due to the lost tax income from potential opportunities not being developed. Wood Mackenzie estimates a cumulative shortfall in government revenue in the period 2016 to 2025 to potentially reach $144 billion if sub-economic fields do not get developed.[2]

Another Wood Mackenzie study from August 2010 estimated that approximately $10 to $17 billion in direct upstream investment in this country is at risk per year if the Section 199 and other tax provisions are repealed for our industry.

Increasing taxes on oil and natural gas producers would unwisely discriminate against certain U.S. workers, make American companies less competitive against others, and discourage future energy investment that would strengthen the economy of this country.

2. How does U.S. tax policy influence company decisions to invest in the United States to develop new energy sources?

A: Sustaining and growing our production of oil and natural gas to meet growing global needs requires a dynamic investment discipline that allocates capital toward the most promising and cost-effective supply prospects. An element of that capital allocation evaluation is the overall cost structure associated with each project, including taxes. Investment decisions are therefore made on an individual asset basis, and increasing taxes may cause certain projects to become uneconomic for investment purposes.

Crude oil and natural gas development is a global enterprise. As such, the alteration of regulatory or tax policies has the potential to divert investment capital toward or away from certain countries relative to other opportunities. *[See, ExxonMobil answer to questions from Senator Baucus, June 20, 2011, pp. 2–3].*

In addition, the stability of tax policy plays a very significant role for our company when making domestic investment decisions. Investments in oil and gas exploration and development projects require a long term

---

[2] Wood Mackenzie, *Energy Policy at a Crossroads: An Assessment of the Impacts of Increased Access Versus Higher Taxes on U.S. Oil and Natural Gas Production, Government Revenue, and Employment*, revised June 24, 2011, p. 22

commitment of massive amounts of capital. As evidenced in recent history, the oil and gas business is highly cyclical, and the fact that prices may be relatively high provides no guarantee that they will stay that way throughout the 20–30 years of a project's life.

Sufficient capital exists to invest in domestic projects within our company, within our industry, and within the capital markets that oil and gas companies may access. But the question is whether the investor has a reasonable prospect, taking into account the huge uncertainties associated with such investments, to realize an acceptable return over the project life for undertaking such risks. Adverse changes to tax laws not only reduce the value of investments made in reliance on those rules, after the fact, but inject even more uncertainties and risks for future projects. And increasing taxes on U.S. oil and gas investments will result in less domestic investment, and ironically, even greater reliance on foreign imports. *[See, ExxonMobil answer to questions from Senator Roberts, June 20, 2011, pp. 18–19].*

3. Would you support a review of all business and individual tax provisions in the context of broad tax policy reform?

   A: Yes. Please see our answer below to Senator Coburn's Question #2 addressing our position on corporate tax reform.

REVENUE TO THE TREASURY

1. What amount have your companies spent in terms of bonus bids for lease sales and royalties going to the Treasury?

   A: ExxonMobil royalty and lease bonus payments have exceeded $2.1 billion in the past three years alone (2008–2010).

   Federal royalties are paid in "royalty in value" (paid in dollars) and "royalty in kind" (paid with oil/gas commodity). The $2.1 billion represents the combined totals for royalties in value and an estimated value for royalty in kind volume.

HELPING OPEC

1. Is the U.S., relative to other countries, a high cost place to conduct oil and gas operations?

   A: It is generally well known that oil and gas exploration, development and production costs are greater in the United States than in many other parts of the world, as a result of many factors ranging from labor costs to geological fundamentals in terms of well productivity. A critical distinguishing factor in the relative evaluation of energy resource development opportunities,

however, is the stability and soundness of existing regulatory, tax and legal policy frameworks.

In order to attract the capital investment needed to realize the benefits of energy development, consistent, balanced policies should be in place. On the demand side, energy policies should ensure a level playing field for all fuel types in the context of free markets, unencumbered by arbitrary subsidies or mandates. When policymakers begin to pick specific energy sources, technologies, companies or regions as winners or losers — in terms of direct subsidies, mandates or unsound fiscal or regulatory processes that unfairly favor or burden certain options — the final outcomes generally undermine investment prospects and cause higher consumer energy prices and economic harm. The same is true of the need for a consistent legal framework that honors the sanctity of contracts and resists proposals to legislate retroactive leasing terms, e.g., so-called "use it or lose it" proposals for "diligent development" beyond governing lease terms or attempts to alter royalty provisions.

ALTERNATIVE ENERGY PRODUCTION

1. How will tax increases as proposed in S. 940, impact your companies' investments in alternative energy?

   A: S. 940 is discriminatory, would adversely affect domestic oil and gas investment and production, and would make U.S. companies less competitive outside the U.S. S. 940 would adversely affect U.S. jobs and would harm, not help, energy development and reliable, affordable alternatives available to Americans.

From Senator Tom A. Coburn, MD

The following Questions are directed for each of the Committee's witnesses

1. In light of the budget crisis our country faces, would your company be willing to take a cut to help the country?

   A: Raising taxes on American business would reduce business activity, not increase it. We would suggest a far more effective way for our industry to contribute to increasing revenues is via pro-growth policies that *increase* the domestic production of energy, reduce the burden on government by increasing employment, *and* add to federal and state government revenues. Recent studies show that opening up access to oil and natural gas resources that have been kept off-limits historically could create up to 530,000 jobs by the year 2025, and as much as $1.7 trillion in government revenue over the life of the resources. (See, *Energy Policy at a Crossroads: An Assessment of the Impacts of Increased Access versus Higher Taxes on U.S. Oil and Natural Gas Production, Government Revenue, and Employment, (January 2011); ICF International Study, "Strengthening Our Economy: The Untapped*

U.S. Oil and Gas Resources," (December 2008)). In short, policies focused on reviving economic growth are also best-suited to restoring sustained growth in federal revenues which, in combination with spending restraint, would most soundly address systemic budget deficits.

Finally, ExxonMobil's federal taxes are large, in absolute and relative terms. During the second quarter of this year, we incurred $3.5 billion in tax expenses in the United States versus $2.8 billion in earnings. In 2010, ExxonMobil's total taxes and duties to U.S. governments topped $9.8 billion, which includes income tax expense of nearly $1.7 billion. *Over the past five years, ExxonMobil's total U.S. tax expense of all kinds was almost $59 billion, which is $18 billion more than our U.S. operating earnings during the same period.*

2. Would you be willing to forgo each of the industry's tax advantages altogether if the following were true:

   A. federal assistance for alternative energy was also eliminated to ensure true competition among technologies;
   B. the corporate tax rate for all industries was reduced to establish a competitive business environment;
   C. energy companies were allowed to fully access our nation's extensive natural resource deposits—including in ANWR, the Outer Continental Shelf, the Gulf of Mexico, and the various shale plays across the country;
   D. the regulatory process for energy leasing was streamlined—particularly as it relates to environmental permitting?

A: The question refers to "the industry's tax advantages" and in prior submissions to the Committee we have disagreed with that characterization, especially when it is made in reference to the legislation proposed by Senator Menendez (S. 940). As we stated in a prior answer to a similar question from Senator Baucus, while one would not know it from the incorrect descriptions used, current tax rules already single out integrated oil and gas companies for discriminatory tax treatment versus their competitors in the same business (e.g., the IDC and G&G rules in the existing code). Within the broader energy industry, on a unit of energy produced basis, renewable and alternative energy producers receive enormous tax credits and cash grants that are not available to oil and gas producers. Further, all other domestic producers and manufacturers receive a 9% deduction under section 199, while oil and gas companies are limited to a 6% deduction. That hardly seems a special preference to the oil and gas industry.

In the international arena, most of ExxonMobil's non-U.S. competitors are residents of countries that impose a territorial system of taxation on foreign income. The U.S., on the other hand, taxes its resident companies on their worldwide income. The negative impact of the worldwide system of taxation is mitigated by the availability of the foreign tax credit, but since Congress continues to make and propose changes to longstanding rules, this is hardly a "favorable tax environment." Proposals like the "dual capacity" changes in

S. 940, for example, would impose double taxation solely on three American-based oil and gas companies. *[See, ExxonMobil answer to questions from Senator Baucus, June 20, 2011, pp. 3–4].*

On the question of our position on corporate tax reform, ExxonMobil supports efforts to simplify and reform the tax rules in the U.S. to provide a reliable, predictable framework for taxation that is administered in a fair way to provide a level playing field for all. We believe that tax reform should allow U.S. businesses to compete successfully in the global economy, attract foreign investment to the U.S., increase capital for investment, and drive job creation in the United States. ExxonMobil would welcome the opportunity to work with Congress to achieve this goal.

Specifically, we would support comprehensive tax reform that looks at all provisions of the tax code, is neutral across industries, promotes growth, and brings the rates down as low as possible. With respect to the tax treatment of energy sources, we do not believe that Congress should single out one type of energy, technology, investment or industry from others for substantially different tax treatment. We need all forms of domestic energy production and our tax and regulatory code should be as neutral and even-handed as possible. We would support the elimination of tax credits that relate solely to oil and gas, such as the enhanced oil recovery and marginal well credits, provided that similar items for other energy sources are also eliminated. This is what neutrality requires — i.e., if energy specific incentives are to be eliminated for some, they should be eliminated for all.
[See, ExxonMobil answers to questions from Senators Snowe and Cantwell, June 20, 2011, pp. 24, 29].

We also endorse the general principles of tax reform recently issued by the U.S. Chamber of Commerce, as follows:

a. Tax reform legislation should lower the corporate tax rate to a level that will enable U.S. businesses to compete successfully in the global economy, attract foreign investment to the United States, increase capital for investment, and drive job creation in the United States. Congress should adjust individual tax rates so that the corporate rate reduction will not negatively impact pass-through entities.

b. In addition to reducing tax rates, tax reform should eliminate the bias in the current U.S. tax system against capital investment. Capital investment should be expensed or recovered using a capital cost recovery system that provides the present value equivalent to expensing with due regard to the impact the system may have on cash flow.

c. In the international arena, the current worldwide tax system should be replaced with a territorial system for the taxation of foreign source income to enable U.S. businesses to compete successfully in the global economy, as well as domestically against foreign firms, and to promote economic growth domestically.

d. Changes should be permanent to ensure certainty for businesses striving to expand, create jobs, and remain competitive in the United States and abroad.

e. Fundamental reform should take place in the near-term, and Congress should not, in the interim, adversely change the current tax policy.

f. Congress preferably should pass comprehensive tax reform legislation; conversely, Congress should avoid undertaking tax reform on a piecemeal basis.

g. In considering tax reform legislation, Congress should give equal attention to government spending to strike a reasonable balance with a tax code that fosters economic growth, job creation, and investment.

h. Congress should enact simple, predictable and easy to understand tax rules to improve compliance and reduce the cost of tax administration.

i. Tax reform legislation should ensure that no specific industry, sector or income group disproportionately bears the burden of paying for tax reform. Tax reform should result in a tax code that allows the marketplace, not the tax system, to allocate capital and resources.

j. Comprehensive tax reform should include realistic transition rules to provide adequate time for implementation and help minimize economic hardships businesses may encounter in transitioning to the new tax system.

[See, ExxonMobil answer to questions from Senator Enzi, June 20, 2011, pp. 26–27].

Finally, as noted in the previous answer, we would support policies to expand access and improve processes to develop domestic energy resources. Your question at subsections C and D inquires whether ExxonMobil would be willing to "forgo… tax advantages" in exchange for pro-growth policies. We question why this is framed as an "either/or" proposition, i.e., Congress will enact pro-growth policies in exchange for industry agreeing to punitive, anti-growth tax increases. Aside from disputing the existence of undue industry "tax advantages," we believe that it would be highly counterproductive to cancel out the potential benefits of pro-growth policies with discriminatory, anti-growth tax increases.

3. The American Petroleum Institute estimates the 9.2 million employees in the oil and gas industry earn over $90,000 per year (upstream and downstream job average—not including retail station sales). One of the nation's largest independents

employing over 5,000 pays its employees: (l) $176,000 per year for engineers, geologists, etc.; (2) $138,000 per year for professional staff, such as accountants, human resources, etc.; and (3) $52,000 per year for clerical and administrative staff

What is the average salary for your employees?

A: ExxonMobil has approximately 30,000 regular employees in the U.S. The level of annual salary varies across the company. The basis of our compensation program is to compensate each individual, executive or non-executive at a level that recognizes the individual's experience, performance and level of responsibility. Our compensation program is designed to be competitive with that of persons performing similar jobs at other companies with whom ExxonMobil competes for employee talent. Salary information is highly competitive and there are legal sensitivities to sharing such information externally.

4. What are the three things Congress can do to lower gas prices?

A: *Support Free Markets:* History shows clearly that arbitrary government intervention in the oil and fuels markets – through mandates, unwarranted regulation, or punitive, discriminatory taxes – ultimately fails consumers. Mandates that create artificial markets and demand, for example, distort investment flows and therefore tend to increase energy prices over the long term. Similarly, releasing strategic governmental reserves solely to mitigate short-term price increases could, over the long term, undermine private investment in inventory reserves and potentially upstream investment, with longer-term negative supply implications. In addition, if Congress' objective is to keep U.S. energy prices affordable, arbitrarily singling out oil companies for punitive tax increases would be counterproductive, reducing capital available for investment relative to other competing activities and industries. As was the case with the Windfall Profits Tax in the 1980s, the impact of distorting capital investments in the energy sector through punitive tax code provisions was to undermine the development of additional domestic energy supplies that could put downward pressures on prices.

Policies that instead foster American manufacturing, production innovation and resource development can have a dramatic, positive effect that increases energy supplies and improves efficiencies, lowering consumer costs. A prominent example is the market's response to vastly increased domestic natural gas reserves and supplies in recent years, made possible by technological innovation achieved in a free market context. As recently as 2006, domestic natural gas prices increased to above $14.00 per MBtu, but now are in the $4.00 range. The free market's cultivation of technology gains enabled the natural gas development renaissance in the United States -- not a federal mandate, aggressive regulation, or discriminatory tax measure (although renewable energy tax credits and other incentives in place for many years placed natural gas at a market disadvantage). This dramatic change in America's U.S. energy supply profile will contribute significantly to increased national energy security and the production of cleaner, more efficient

electricity generation for many decades in the future; allowing the market to function without undue intervention is at the root of this positive outcome.

In that regard, in the area of transportation fuels, EPA and Department of Energy (DOE) should complete the "Fuel Harmonization" study called for under the 2005 Energy Policy Act which was due to Congress in June 2008. It would address the supply and cost implications associated with local and/or regional fuel blend mandates and variations. In a May 2011 letter to EPA Administrator Lisa Jackson, thirty-six Senate and House members cited the Energy Information Administration's 2002 study of "boutique fuels" and its negative impact on gas price volatility. The letter urged the agencies to look at ways "... to better inform us on how the reduction of unnecessary domestic energy constraints caused by the proliferation of boutique fuel use will affect the price of gasoline." The letter also stressed: "Unfortunately, EPA and DOE never did the report, and [have] provided no explanation as to why [they] disregarded [their] congressional directive." (The letter is attached).

Increase Access and Supplies: Policies that expand safe and reliable access are critical to our nation's ability to benefit from the vast supplies of North American energy. And the returns are not simply increased energy supplies exerting a downward pressure on prices. Producing these resources also could go a long way toward addressing some of our nation's biggest economic challenges: high unemployment and government deficits. As noted previously, recent studies have shown that opening up access to energy resources that have been kept off-limits could create more than 500,000 new jobs by the year 2025[3], or create as much as $1.7 trillion in government revenue over the life of the resources[4].

Increased access to North American resources, whether offshore, in the multiple U.S. shale regions, or in the oil sands of neighboring Canada, can certainly have a positive influence on market supplies, while enhancing energy security. The Administration's approval of the Keystone XL pipeline from Canada to U.S. Gulf Coast refineries, for example, would help ensure safe, abundant, and reliable fuel supplies for American consumers, as would repeal of the counterproductive Section 526 of the Energy Independence and Security Act of 2007 that potentially restricts federal procurement of fuels from Canada.

Taxes

One of the most important steps the government could take to promote additional energy supplies is to keep from changing, and threatening to further change, the tax laws on oil and gas activities. Based on tax changes enacted in 2005-2008, major integrated oil and gas companies have seen tax increases in five of the six years from 2005-2010. Additional punitive tax changes have been proposed in each of the last several years, including this year. Increased taxes, and the threat of additional increases, adversely affect

---

[3] Wood Mackenzie, Energy Policy at a Crossroads: An Assessment of the Impacts of Increased Access Versus Higher Taxes on U.S. Oil and Natural Gas Production, Government Revenue, and Employment, revised June 24, 2011

[4] ICF International, *Strengthening Our Economy: The Untapped U.S. Oil and Gas Resources*, December 5, 2008

investment. A clear, sound, stable and pro-growth tax policy regarding oil and gas would maximize investment, thereby increasing supplies.

5. What was your effective tax rate last year?

A: Our worldwide effective income tax rate in 2010 was 45 percent and over the 2005–2010 period was 44 percent.

6. What is your total tax benefit that you receive from the provisions targeted by recent proposals to eliminate existing tax advantages for your company?

A: We do not believe our business receives any significant special tax benefits from the current tax system. Please see our prior responses to Senator Baucus' Questions 3 and 4 for an explanation of the tax provisions under consideration in S. 940 and how these provisions impact our business. *[See, ExxonMobil answer to questions from Senator Baucus, June 20, 2011, pp. 3 - 10].* In addition to the three items discussed in the responses to Senator Baucus' questions, S. 940 would repeal provisions for percentage depletion for oil and gas production and certain rules related to cost recovery of geological and geophysical (G&G) costs. The five companies targeted by S. 940 do not qualify for percentage depletion for oil and gas production nor the favorable G&G provisions.

The final question is directed towards Mr. Tillerson, Chairman and Chief Executive Officer, Exxon Mobil Corporation:

7. The proposals to eliminate oil and gas tax advantages are estimated to raise $18.54 billion over five years. Meanwhile, the cost of the Volumetric Ethanol Excise Tax Credit (VEETC) has cost over $24 billion over the last five years and will reach $30 billion if left intact through 2011.

As a blender of ethanol—if not the largest of them—would eliminating the VEETC be a logical first step in eliminating oil and gas tax advantages, especially considering ethanol has already been granted a guaranteed market share by Congress?

A: ExxonMobil believes the ethanol tax credit is not needed to ensure demand today for domestic ethanol production or for meeting existing transportation fuel needs.

John S. Watson
Chairman and Chief Executive Officer
Chevron Corporation
Statement Prepared for the Hearing on
"Oil and Gas Tax Incentives and Rising Energy Prices"
U.S. Senate Committee on Finance
May 12, 2011

Mr. Chairman, Ranking Member Hatch and Members of the Committee: I'm John Watson, Chairman and CEO of Chevron Corporation.

Affordable, reliable energy is the backbone of America's economy and competitiveness. Fortunately, our nation is endowed with abundant supplies of energy, including oil and natural gas.

Each time we come to Capitol Hill, we advocate for measures that would better help America develop our energy supplies. More domestic supply, along with aggressive measures to use energy more wisely, is one of the most effective ways to counter rising energy prices, enhance our energy security and stimulate economic growth.

Tax increases on the oil and gas industry – which will result if you change long-standing provisions in the U.S. tax code – will hinder development of energy supplies needed to moderate rising energy prices. It will also mean fewer dollars to state and federal treasuries…and fewer jobs – all at a time when our economic recovery remains fragile and America needs all three.

Because my time is limited, I want to make three points today.

First, the oil and gas industry pays its fair share in taxes.

Despite the current debate on energy taxes, few businesses pay more in taxes than oil and gas companies. The worldwide effective tax rate for our industry in 2010 was about 40% – that's higher than the U.S. statutory rate of 35% and the rate for manufacturers of 26.5%.

Between 2005 and 2009, our industry paid or accrued to the U.S. government almost $158 billion in taxes, royalties and fees, including $98 billion in federal income taxes. That totals nearly $86 million a day.

Changing important tax provisions outside the context of broader corporate tax reform would achieve one unmistakable outcome – it would restrain domestic development and reduce tax revenues at a time when they are most needed.

Likewise, calls to raise royalty fees will increase the cost of doing business in places like the deepwater Gulf of Mexico and impede development of these resources just when we are getting back to work.

Second, long-standing oil and gas provisions in the tax code parallel tax treatment of other industries or are designed to prevent double taxation of income.

For all U.S. businesses, a basic tax principal is that they are taxed on income after costs. All companies, in all sectors, may deduct these costs in various ways. The oil and gas industry can deduct intangible drilling costs – such as site preparation, labor, engineering and design. These expenses are similar to the research expenses deducted by pharmaceutical and technology firms. These deductions allow companies to recover the costs of risky investments necessary for the viability of their business.

The tax provisions some seek to change are long-standing provisions in the tax code. Many apply to other segments of the U.S. economy, including the manufacturer's deduction and LIFO accounting.

We are deeply concerned about proposals to curtail foreign tax credits for dual capacity taxpayers. Credits for foreign income taxes are critical because without these credits – which are available to all taxpayers – we would pay tax twice on income generated overseas. This would make us less competitive internationally and cost U.S. jobs that support our overseas operations.

My third point is that there should be equitable treatment for all forms of energy and for all energy producers – large and small.

I am an advocate for developing all forms of energy and using energy more wisely. But it is wrong to increase taxes on oil and gas companies to subsidize other forms of energy. This is also likely to have serious unintended consequences for production, jobs and tax revenues.

Singling out five companies because of their size is even more troubling. Such measures are anticompetitive and discriminatory. After all, our five companies are providing the technical, operating and managerial expertise that is allowing the global energy industry to operate at the forefront of energy development.

Let me close by suggesting that the most sensible path is simple – don't punish our industry for doing its job well. Create energy and tax policies that make our country a more attractive place to do business. Allow us to develop our nation's vast energy resources. And strengthen, don't weaken, our ability to compete against large national oil companies who are major players in the U.S. and global energy markets.

Responsible development of our resources – which will be enabled by sound tax and energy policy -- will add more high-paying jobs; provide billions in new tax revenues; and reduce our dependence on foreign energy sources.

If our nation's concern is keeping investments here at home and ensuring reliable, affordable energy for all Americans – then what we ask for here is what we look for anywhere we invest: conditions that are not punitive and discriminatory – but stable, transparent and equitable.

Mr. Chairman, I'm proud to lead a 132-year-old American company…I'm proud of the vital role we play in our economy…and I'm proud that our profits allow us to make significant investments in our communities and in the long-term health of our country.

Thank you.

Responses Submitted by Chevron to Follow-up Questions
From the May 12, 2011 Hearing by the
Senate Finance Committee

The Honorable Max Baucus

1. **Exxon Mobile has a recent posting by Ken Cohen, V.P. of Public and Government Affairs on its "policy blog" titled "ExxonMobil's U.S. taxes and U.S. earnings—Some relevant numbers for Washington. Mr. Cohen states that ExxonMobil had total tax expense of $9.8 billion in 2010 which exceeded total U.S. operating earnings of $7.5 billion. Footnote 18 of ExxonMobil's the 2010 Form 10-K filed with the SEC provides a breakdown of the total $9.8 billion. It includes $6.2 billion in "sales-based taxes".**

   I would like to ask each of you to describe the nature and amount of these U.S." sales based taxes" that you include as a tax expense in your financial statements. Are they federal excise taxes that are included in the price at the pump and effectively paid by consumers? Also, are these amounts included in your total sales reported on the income statement and therefore offset the amount reported as an expense?

   If these taxes are effectively passed on to consumers, isn't describing them generally as taxes paid by your companies similar to a retailer claiming that they pay the state and local sales taxes that they collect from consumers and remit to the appropriate governmental authorities.?

   Response: Federal excise taxes are imposed on motor fuels, including 18.4 cents per gallon on gasoline and 24.4 cents per gallon on diesel fuel. Chevron's 2010 U.S. expense for excise and similar taxes on products and merchandise was almost $4.5 billion. Chevron collects these taxes and remits them to federal, state and local governments. They are included in our corporation's 2010 Annual Report's Consolidated Statement of Income under "Sales and other operating revenues" and "Taxes other than on income".

2. **According to ExxonMobil's 10-K for 2010, for every 1 dollar increase in the price of oil, ExxonMobil earns a 375 million after-tax profit.**

   Last year, the average price of a barrel of oil was 72 dollars. The price of oil today is around 100 dollars and is projected to average over 100 dollars for the year.

   Doing simple math, if prices do average 100 dollars this year, ExxonMobil stands to earn in excess of 10 billion dollars in additional profit in 2011 than in 2010 just due to the increase in the price of oil.

   In contrast, the total amount of tax breaks under consideration today is approximately 2 billion dollars for all the companies at the table combined.

   I'd like to know from the other four companies how much in after-tax profit you earn from each 1 dollar increase in the price of oil.

Wouldn't each of you agree that a price change of two or three dollars in a barrel of crude oil has a more meaningful impact on your investment decisions than your share of the effect of repealing all the tax provisions under consideration today?

Isn't the value of a price of oil the most important driver for your business planning?

Would you really consider producing less in the United States with the significant profits you earn with every additional barrel of oil produced?

Response: For Chevron, an internal "rule of thumb" regarding earnings/crude price sensitivity is that corporate earnings change approximately $300 million a year for every dollar change in crude price. This rule is only of reasonable accuracy over limited crude price ranges. For widely varying prices, certain contractual elements may change, e.g. variable royalties and incremental taxes, that make the earnings impact less predictable.

The price of crude oil is one of many important drivers for our business planning. Oil prices rise and fall principally because of supply and demand fundamentals in the market. Crude oil and natural gas prices are subject to external factors over which the company has no control, including product demand connected with global economic conditions, industry inventory levels, production quotas imposed by OPEC, weather-related damage and disruptions, competing fuel prices, and regional supply interruptions or fears thereof that may be caused by military conflicts, civil unrest or political uncertainty.

Because of the long-term nature of the investments we make (often our projects can operate 50 years or more), our investment decisions are based on a variety of factors, but are not linked to short-term prices. Costs for steel, equipment and rigs have increased dramatically over the last decade and are on the rise again as the world economy strengthens. According to IHS CERA Inc., upstream construction costs increased 5% in the past six months, the highest escalation since the third quarter of 2008.

Over the past ten years, Chevron's investment profile has remained strong and is driven by the reality that America and the world will continue to need new energy supplies. We are actively responding to the rising energy demand of the United States and countries around the world – investing aggressively to develop energy supplies to meet today's and tomorrow's needs. Chevron is developing a portfolio of major capital projects that include some of the largest and most pioneering ventures in the industry. Chevron's annual capital and exploratory expenditures exceed our annual net income. Over the 2001 to 2010 period, Chevron invested over $150 billion exploring for and developing and producing energy the world needs, compared to earnings over that same time period of almost $130 billion. Chevron last year earned $19.1 billion and plans to reinvest approximately $26 billion back into the business in 2011, with 87% of that investment directed towards the exploration for, and development of, oil and natural gas resources.

Our decisions to invest in the development of energy sources depend upon our access to these opportunities as well as the stability of the fiscal terms governing these investments.

Chevron favors making investments where fiscal terms are stable. The longstanding tax provisions under consideration for repeal play an important role in the economics of exploration and development projects, and there is no question that repealing such tax provisions would undermine the economics of projects on the margin, which in turn will discourage new domestic energy production at a time when new supplies are critical for sustaining economic recovery, energy security and job growth.

3. **Some of the witnesses have testified that the oil and gas industry is already subject to high effective income tax rates. They refer to overall effective rates in excess of 40 percent. But these rates appear to be a weighted average of both U.S. and non-U.S. income tax rates applied to domestic and foreign earnings.**

   From financial reports filed with the SEC, it appears the effective U.S. income tax rates are significantly lower than the average foreign rates. It seems that the high foreign rates are pushing up the total reported effective rate. One of the companies stated in their financial disclosure that the weighted average statutory tax rate in countries in which they operate was 55.3 percent for 2010.

   I would like to ask each of you what the U.S. tax rate is on just your U.S. income. And how does that compare to foreign tax rates you pay on your non-U.S. income?

   So isn't the U.S. actually a favorable income tax environment in which to engage in production, refining and distribution?

   And wouldn't that still be the case, even if these subsidies did not exist?

   Response: In 2010, Chevron's effective tax rate in the United States was 31.5%. The same year, our effective tax rate internationally was 42.5%, yielding an effective worldwide income tax rate for 2010 of 40.3%. We pay a significant amount in taxes. Chevron's total U.S. income tax expense in 2010 was about $2.1 billion, while international income taxes were $10.9 billion. We pay more taxes overseas where a significant part of Chevron's profits are generated and where most of our production activities are located. Chevron's total tax liability in 2010, including income, excise and value added taxes, was over $31 billion. The industry pays over $86 million a day in income taxes, royalties, bonuses and rents to the federal government. The industry's effective worldwide income tax rate in 2010 was 41.1%, higher than both the U.S. statutory rate (35%) and the average rate for industrial companies (26.5 percent). Our margins are in line with -- or below -- other sectors, while our effective tax rate is much higher than other sectors.

   Between 2005 -2009, the effective tax rates for major retailers were in the 35-40% range, for technology companies in the 22-31% range, for financial services companies in the 21-31% range, and for pharmaceutical companies in the 18-30% range.

   Punitive taxes would discourage new domestic energy production, both for alternatives and traditional oil and natural gas production – increasing our dependence on imported oil and

decreasing our global competitiveness. Eliminating or changing long standing tax provisions that allow for the deduction of legitimate business expenses will restrict our ability to invest in the oil and natural gas that America needs. We believe there should be equitable treatment for all forms of energy and for all energy producers, large and small. Energy and tax policies should allow us to develop our nation's vast energy resources, strengthening our ability to compete against large and powerful national oil companies who are major players in the United States and global energy markets.

4. **Current tax rules arguably allow foreign tax credits for payments that are economically equivalent to royalties.**

   The proposal under consideration would limit creditable foreign taxes to generally applicable foreign taxes.

   The three largest US oil companies are on pace to earn 80 billion dollars in aggregate profit in 2011. Making the proposed changes to the foreign tax credit rules would cost your companies less than one percent of that profit.

   Is it a serious problem for your company to pay less than 1% of your profits for the proposed modification?

   Response: The foreign tax credit is a longstanding provision in the U.S. tax code that is designed to prevent double taxation of foreign-sourced income. Current tax rules draw a clear distinction between foreign tax payments and royalties and only allow a foreign tax credit for the former. These tax rules include both well-established court cases and Internal Revenue Service regulations. Under the rules, the taxpayer, not the IRS, bears the burden of proving that a particular payment is an income tax. Unless the taxpayer can meet this burden of proof, it cannot claim the payment as being creditable. Moreover, the foreign tax credit rules do not turn upon whether the foreign jurisdiction calls the levy an income tax but whether the levy is an income tax in the U.S. sense using U.S. tax law principles.

   The discriminatory elimination of the foreign tax credit for dual capacity taxpayers would result in double taxation of our foreign earnings, making us less competitive internationally against non-U.S. oil companies, including National Oil Companies, and cost the United States revenues and jobs that support our overseas operations.

   We do not believe that U.S. tax policy should be driven by a snapshot of annual earnings of a single sector of the economy. Instead, tax policy should be driven by a set of established goals, including creating an environment that encourages long-term investments through a stable and predictable fiscal regime.

   The energy business is a global business. To meet growing global and U.S. demand, it is vital that we develop energy resources at home and abroad. Any new limitation on foreign tax credits would seriously impact the competitiveness of U.S.-based companies vis-à-vis foreign multinationals, at a time when funds are needed to secure additional sources of

energy. When we operate overseas we incur taxes in the jurisdictions where we operate. In 2010 we incurred almost $11 billion in foreign income taxes.

5. **In 2005, the then-CEO of your company was a witness at an Energy and Natural Resources hearing regarding energy and prices and profits. At that hearing, the then-CEO of your company testified that these tax breaks would have a minimal impact on your company. When Americans are tightening their belts and some in Congress are proposing taking away benefits for senior citizens to reduce our deficit, why should we continue to spend scarce taxpayer resources on these tax breaks when the impacts for your company are so minimal?**

   Response: Chevron indicated then and still believes that in the current market environment new tax provisions are not needed for oil and natural gas exploration. Regarding the oil and gas tax provisions in the 2005 energy bill, which included 2-year geological & geophysical amortization and 50% expensing for certain refinery expansion projects, our then Chairman and CEO testified that those tax breaks would have minimal impact on Chevron but also stated that these tax breaks affected others in the industry. At no time have we testified in support of eliminating long-standing provisions in the tax code that apply to the oil and natural gas industry, such as the deductibility of legitimate business expenses, including intangible drilling costs.

   Eliminating longstanding tax provisions will result in less capital available for new investments to develop new energy supplies, reducing U.S. oil and natural gas production, energy security and U.S. jobs.

The Honorable Max Baucus on Behalf of The Honorable Harry Reid

1. **How much did your company spend in 2010 in the US on the research, development, demonstration or domestic production of clean, non-petroleum-based alternative transportation fuels? Please also identify the amount by which that estimated expenditure was effectively reduced through Federal tax deductions or tax credits, such as the research and development tax credit, claimed by the company.**

   Response: Chevron spent $4.4 billion globally from 2002 to 2010 on development and related operational costs for renewables and alternatives, including geothermal, biofuels, advanced batteries, wind, and solar, as well as on efficiency measures. The annual totals and/or more detailed breakdowns of these expenditures are proprietary business information, which we need to keep confidential for competitive reasons.

   We are researching non-food feedstocks and conversion technologies to develop advanced biofuels at a commercial scale. Catchlight Energy, a joint venture with Weyerhaeuser, is developing technologies for converting cellulose and lignin into renewable, advanced biofuels from non-food sources. Collaborative research with the University of California at Davis is focused on developing commercially viable processes for the production of transportation fuels from renewable sources such as new crops, forest and agricultural

residues, and municipal solid waste. As a matter of policy, Chevron does not believe that foodstuffs should be used in the production of alternative fuels.

The Honorable Ron Wyden

1. **When arguing for opening up US lands and waters for oil drilling, the oil industry complains that because most oil is controlled by foreign governments, the US oil industry has no place else to go for access to oil and gas resources except in the US. But at today's hearing, you testified that if you lost the tax breaks you currently receive, more oil exploration and production would go offshore.**

   How can you claim both that you have no place else to go to drill for oil outside the US and that if you lose tax breaks you'll move operations offshore? Isn't that a contradiction?

   Response: Chevron does business around the world and we have not argued that it "has no place else to access oil and gas resources except in the U.S." While access to some overseas resources may be limited, we go to the countries where these opportunities exist and where the fiscal terms are stable and predictable.

   Chevron has a variety of opportunities that it evaluates for development and we make our investment decisions based upon where we can achieve the greatest returns for our shareholders. In 2011, we have budgeted over $17 billion on exploration and production outside the United States, primarily focused on major development projects in Angola, Australia, Brazil, Canada, China, Nigeria, Thailand, and the United Kingdom. We have also budgeted more than $5 billion for investment during 2011 in exploration and production projects in the United States.

   Changes in the tax code may adversely affect the economics of the projects that we are considering in the United States and affect our future investment profile. As additional opportunities have become available to us in the United States, we have expanded our investment profile significantly, with major gains for the communities and states where we operate, including increases in revenues to local, state and federal treasuries.

   There has never been a more urgent need to be realistic about the energy system's interdependence and its size and scale. We also need to recognize the magnitude of resources—financial and organizational—needed to keep it operating. Today's energy infrastructure requires substantial, ongoing investment to sustain production, tap new resources and meet growing demand.

2. **During this morning's hearing, Mr. McKay responded that he agreed that it was appropriate to phase out the ethanol blending credit in light of the statutorily-mandated renewable standard requirement. Do you agree with Mr. McKay that it is time to phase out the ethanol blending credit?**

Response: We believe the ethanol tax credit is not needed to ensure demand today for domestic ethanol production or for meeting existing transportation fuel needs.

The Honorable John Thune

1. **I want to discuss a particularly promising area of our country for domestic energy production, the Williston Basin located under parts of North Dakota, South Dakota, Montana and Canada. Some have called this area "Kuwait on the Prairie" because it holds the largest oil and gas find in North America since the Prudhoe Bay discovery in Alaska in the 1960s. Can you comment on the potential for job creation and economic development in the states I mentioned related to these oil and gas reserves. Would the tax increases in the President's budget and the legislation sponsored by Senator Menendez make you more or less likely to increase domestic production from these reserves, were these tax increases to be enacted into law?**

   Response: Chevron does not produce oil or natural in the Williston Basin. According to the API, the oil and natural gas industry supports almost 100,000 jobs which add over $9 billion in economic output in the states of North Dakota, South Dakota and Montana. Located in the Williston Basin, the Bakken formation of North Dakota and Montana could contain over 4 billion barrels of technically recoverable oil. Eliminating or changing important tax provisions would restrain incremental oil and natural gas development, including in the Williston Basin, resulting in restricting high-paying U.S. jobs, reducing tax revenues to those states, and increasing our dependence on foreign energy sources.

The Honorable John D. Rockefeller

1. **What was the average annual compensation for your company's top 5 executives over the past decade? Last year?**

   Response: Chevron's executive compensation information is reported in Chevron's Annual Meeting and Proxy Statements to shareholders and the SEC. [See Attachment I]

2. **What is the single most important tax incentive your business receives? Why?**

   Response: Chevron makes investment decisions based upon stable and predictable investment regimes. Chevron produces oil and natural gas in 26 countries around the world under a wide range of fiscal regimes. Tax provisions, fiscal terms, and costs of production are among many factors that we consider when determining whether a project is economic.

3. **Two of your highest dollar tax incentives are Dual Capacity and Intangible Drilling Costs. Which of these two provisions is more important to your company and which you would choose to live without if Congress is forced to choose between the two?**

   Response: Chevron supports a stable and predictable tax code and we do not support punitive tax increases on the oil and natural gas or any other industry. Each of these

provisions is important to developing the energy resources that the United States and the world needs. The Dual Capacity foreign tax credit continues a longstanding principle of the U.S. tax code to prevent the double taxation of foreign sourced income. This applies to all sectors of the economy. It would be unfair to eliminate this longstanding policy only for the U.S. oil and natural gas industry, particularly given that it would reduce our competitiveness internationally and increase the relative competitiveness of foreign companies, including the National Oil Companies.

Major oil and natural gas companies deduct 70% of their intangible drilling costs (IDCs), which include site preparation and other drilling costs without salvage value, and amortize the remaining 30% over 60 months. These provisions allow oil and natural gas companies to recover their costs and ensure that only net income is taxed. These expenses are similar to the research expenses deducted by the pharmaceutical and electronics industries – they allow companies to recover the costs of risky investments necessary for the continued vitality of their business.

The elimination of long-standing provisions in the tax code that apply to the U.S. oil and natural gas industry, such as the deductibility of intangible drilling costs, will discourage the tremendous capital investments in production needed to meet the nation's growing energy needs.

4. **Some of you talk in your testimony of discriminatory treatment for your industry. It is my belief your industry has received preferred treatment for a century. Depletion goes back to 1916, and your industry was not eligible for the manufacturing subsidies that the section 199 subsidy replaced. Yet your companies' lobbying efforts allowed you to benefit from 199 when enacted. How do you reconcile such special treatment with claims of discrimination?**

   Response: Percentage depletion taken on U.S. oil and natural gas production by integrated oil and natural gas companies, like Chevron, was repealed in 1975.

   The manufacturer's deduction under section 199 of the Internal Revenue Code was added to the law to foster job creation in U.S. manufacturing. Chevron is allowed a deduction of 6% of its taxable income from domestic operations, which yields a tax rate reduction of roughly two percentage points. The deduction for oil and natural gas income has already been curtailed, when the deduction for other taxpayers was increased to 9% in 2010, oil and natural gas income remained frozen at 6%.

   Changes in the tax code should not disproportionately affect any single industry, nor should they favor one form of energy over another. For all U.S. businesses, a basic tax principal is that they are taxed on income after costs. All companies in all sectors – large or small – may deduct these costs in various ways. These provisions allow companies to recover their costs and ensure that only net income is taxed. Eliminating or changing these provisions amount to a tax increase on energy companies, restricting our ability to invest in the oil and gas that the United States sorely needs. There should be equitable treatment for all forms of energy and

for all energy producers, large and small. Singling out five companies because of their size is even more troubling. Such measures are anticompetitive and discriminatory.

The Honorable Pat Roberts

1. **Understanding that the five companies appearing before us today are all publicly traded, and are about 98% owned by individuals or institutional investors who are managing pension funds, mutual funds and IRAs for millions of middle class Americans that rely on these holdings for their economic security and retirement; what impact do your companies' record profits this past year have on middle class Americans whose economic portfolios invest in U.S. integrated oil companies?**

   Response: Like other U.S. corporations, our company is owned and operated for the benefit of our shareholders, who expect a return on their stock investment. Chevron has a very significant capital investment program, the aim of which is to produce energy across the globe while creating value for our stockholders. As you indicated, most oil company stock is owned by mutual funds, pension funds and retirement accounts, representing millions of Americans. Chevron takes a very deliberate, disciplined approach to capital spending and also returns cash to our stockholders – the owners of our company. Shareholder returns are achieved primarily by our investment of earned profits into our business, as well as dividends paid to shareholders. Chevron paid out over $5.6 billion in dividends on common stock in 2010.

   According to a report issued in April by Sonecon, LLC, investments in oil and natural gas companies made by public employee pension funds sharply out-performed other assets held by the funds. From 2005 to 2009, the share of the funds' returns attributable to oil and natural gas investments was 2.5 times to 2.8 times greater than their share of those funds' assets. The analysis also found that the public pension funds examined achieved returns of 41 percent to 49 percent on their oil and natural gas investments over the five-year period, compared to returns of 10 percent to 17 percent for the same funds' non-oil and natural gas investments.

2. **How significant of a role does certainty in tax policy play for your companies when making investments decisions regarding greater domestic production and, more importantly, when hiring new employees?**

   Response: Chevron makes investment decisions based upon stable and predictable investment regimes. In addition, there have been a number of signals to the market that discourage investment in much-needed traditional oil and natural gas production. Additional, punitive or discriminatory taxes on the U.S. oil and natural gas industry are contrary to the goal of providing stable and cost-effective supplies of energy for American consumers and discourage the tremendous capital investments needed to meet the nation's growing energy needs. Additional taxes discourage new domestic energy projects, thereby increasing our dependence on imported oil and products.

The Honorable Olympia Snowe

1. **With prices as high as $100 the question today is whether our energy tax policies are effectively creating incentives to change behavior – rather than simply making cost-effective business decisions only more profitable.**

   As a result, I find it interesting that in an analysis last year of the implications of removing these tax incentives that the American Petroleum Institute included an assumption that oil is at $80 per barrel. The analysis, done by Wood and Mackenzie, concluded that removing these tax incentives would alter the "breakeven" point for oil - that is the cost for profitability - from an average of $47.00 per barrel to $52.00 per barrel – or 10 percent.

   In addition, the report's executive summary concludes that under scenarios where oil is higher than $80 the removal of oil and gas subsidies would not affect oil production at all. While I recognize that additional subsidies lead to additional production, it would seem that there would be decreasing returns from more and more subsidies for US oil production.

   Specifically, while the report states concerns about the effects on natural gas production with the removal of subsidies the report states, "The impact to the oil market is much lower, as less than 60,000 barrels are at risk under the proposed changes in 2011." Effectively, the report concludes that if oil is priced at points higher than $80 per barrel the removal of these incentives will not result in any lost oil production.

   At a time when oil is priced at roughly $100 – and if these prices were to continue – do you agree with the API report that there would not be any reduced production of oil in the United States if the tax incentives were removed?

   Do you support removing these tax subsidies for oil at a certain point, perhaps the long-term level that EIA or your companies predict that oil will be in 5-10 years?

   Response: Our decisions to invest in the development of energy sources depend upon our access to these opportunities as well as the stability of the fiscal terms governing these investments. Chevron favors making investments where fiscal terms are stable. The longstanding tax provisions under consideration for repeal play an important role in the economics of exploration and development projects, and there is no question that repealing such tax provisions would undermine the economics of projects on the margin, which in turn would discourage new domestic energy production at a time when new supplies are critical for sustaining economic recovery, energy security and job growth. We believe there should be equitable treatment for all forms of energy and for all energy producers, large and small.

   The price of crude oil is one of many important drivers for our business planning. Higher prices for oil provide an incentive to produce more as well as developing new technologies. Because of the long-term nature of the investments we make (often our projects can operate

50 years or more), our investment decisions are based on a variety of factors, but are not linked to short-term prices. For example, the costs for steel, equipment and rigs have increased dramatically over the last decade and are on the rise again as the world economy strengthens. According to IHS CERA Inc., upstream construction costs increased 5% in the past six months, the highest escalation since the third quarter of 2008.

The Wood Mackenzie report's methodology modeled only U.S. onshore and offshore production fields in isolation. It does not take into account the relative economics on a global basis of tax impacts in the United States. In other words, while the study may have found that – when looked at on an individual basis - U.S. field production was not impacted by changed tax policy at prices above $80/bbl, this isn't to say that some companies wouldn't instead choose to invest in overseas opportunities with higher rates of return. Therefore, we don't agree that production would not be impacted by changed tax policy if prices were above $80/bbl.

Eliminating or changing long standing tax provisions, including those that allow for the deduction of legitimate business expenses, amounts to a tax increase on energy companies and restricts our ability to invest in the oil and gas that America needs. We believe there should be equitable treatment for all forms of energy and for all energy producers, large and small. Energy and tax policies should allow us to develop our nation's vast energy resources, strengthening our ability to compete against large and powerful national oil companies who are major players in the United States and global energy markets.

2. **Your company is moving forward with reducing your *own* consumption of energy and expanding your energy efficiency business. For instance, Chevron has established a Corporate Energy Coordinator to lead the company's energy efficiency efforts and has invested in developing the two largest energy efficient buildings in the country in Houston, Texas – both of which have received the energy efficiency rating certifications from Leadership in Energy and Environmental Design.**

   Do you support tax credits and other incentives to increase our country's investment in energy efficiency?

   Response: Chevron, like many businesses, has made the wise use of energy an important business strategy; Chevron has increased its own energy efficiency of global operations by 33% since 1992, and has lowered energy costs by approximately $2 billion per year. Chevron Energy Solutions (CES), one of the largest energy service companies in the United States, helps customers increase energy efficiency, reduce energy use, and distribute low carbon renewable power. CES projects have saved more than $1 billion in energy costs for customers to date and reduced GHG emissions by more than 3 million metric tonnes per year.

   We believe governments should continue to enhance policies to promote efficiency, incentivize the adoption of economic high-efficiency technologies, and remove barriers that prevent adequate investment in economic energy efficiency.

3. **We have witnessed the continued volatility of our energy futures markets, with for instance gasoline prices falling 7.6 percent on May 11th, 2011, coming during a year when gasoline has increased by more than 28 percent. The development yesterday came when the U.S. Department of Energy surprised traders by reporting an unexpected buildup of gasoline stockpiles in the previous week.**

   This situation yesterday raises two critical questions regarding the efficiency of our energy markets. First, as the Commodity Futures Trading Commission is considering now, should we adopt position limits for particular traders to reduce the volatility of specific contracts. As a leader, along with Senators Feinstein and Cantwell, on developing a strong derivative title within the financial reform bill, I strongly believe transparency and restrictions on specific trades will not restrict price discovery, but will reduce volatility and potential for manipulation.

   Secondly, trading on May 11th again demonstrates how critical it is for an efficient market to have access to accurate and timely data. This is not like any other market – information regarding consumption, production, and reserves are controlled, in some instances, by America's adversaries.

   For instance, just last month the Wall Street Journal reported that "unreliable data on production, starting with the world's largest exporter, are adding to the price volatility..." and that the "revelation highlighted a problem that is roiling markets at the moment: a dearth of solid information about the true state of production and supplies."

   As a result of these developments do you believe that the CFTC should adopt strict position limits for speculative traders and do you believe that there is enough transparency in these markets to accurately assess efficient pricing of oil?

   Response: Many factors influence the price of oil, including supply and demand, perceptions of market trends, geopolitical instability, commodity investments, and the value of the dollar. Our view is that efficient and transparent markets work, and measures to increase transparency are helpful. Any policy proposals that discourage liquidity are a concern and must be carefully evaluated for unintended consequences.

4. **Do you believe that current prices are reflective of supply and demand?**

   Response: Yes, as well as other factors.

5. **Do you believe that foreign countries are doing enough to supply the world with information about reserves and production and what can the United State government do to facilitate information sharing?**

Response: Encouraging the transparent exchange of reserves, production, and other relevant data is vital to ensuring efficient delivery of energy, allocation of investment, mitigation of price volatility, and overall efficiency and stability within energy markets. We support transparency of data collection from all market participants and other efforts which increase liquidity in the markets.

6. **The Tax Reform Act of 1986 is constantly referred to as a model for tax reform and the point often made any new reform we undertake should follow its lead, which was to broaden the base and to reduce tax rates. The phrase "broaden the base" is just a clever way of saying "eliminate tax provisions" such as credits and deductions that clutter the code in order to simplify the code and to provide the revenue needed to offset the corresponding reduction in tax rates.**

   The Democrats have presented us with an opportunity to broaden the base by eliminating certain tax provisions, namely, the tax benefits that are available currently to the five companies before us today. But instead of lowering the rates, the plan is to use the revenue from these cuts to pay down the deficit – just another way avoiding the spending cuts that the American people recognize has led us to these deficits.

   The Finance Committee has held a series of tax reform hearings and I thank Chairman Baucus for that. One thing we have learned is that the tax code is filled with too many special provisions and today we are debating yet one more complication to a tax code that is screaming for simplification.

   What we should be pursuing is a comprehensive energy plan at the same time we pursue comprehensive tax reform. There is wide agreement that the rates are too high for our American companies to remain competitive – even the Obama Administration has suggested cutting corporate tax rates. We could start to do so today, with a down-payment made on such rate reductions by the elimination of the oil and gas provisions currently on the table.

   We have to ensure the competitiveness of American companies and cutting the tax rate is one goal where we already have some consensus. We just need to agree on how to get there. Do you agree that reducing tax rates would justify the elimination of the oil and gas tax provisions we are discussing today? Do you think that rather than stop with these oil and gas provisions, we should also eliminate other energy subsidies in order to provide the broadest possible rate reductions?

   Response: We believe that the U.S. federal income tax system should make the United States an attractive place to do business and should allow U.S.-based companies to effectively compete in the global marketplace. To do so, the U.S. tax system must be competitive with those of other countries. We see a growing consensus that the corporate tax rate should be lowered to preserve the global competitiveness of U.S. companies. To the extent that the tax base is expanded by reducing, eliminating or deferring tax deductions and credits, that burden should be shared broadly by all industries and categories of taxpayers.

Changes should not disproportionately affect any single industry, nor should they favor one form of energy over another.

The dual capacity foreign tax credit, which is available to all businesses, is designed to avoid taxing the same income twice, once in the host country jurisdiction and again in the United States. Repealing this provision would place U.S-based companies at a competitive disadvantage with international-based companies.

The Honorable Michael Enzi

You all indicated that you were in favor of overall corporate tax reform. In that regard, I have three questions:

1. **If Congress were to take up corporate income tax reform and eliminate provisions of the tax code that benefit traditional and alternative energy industries, to what rate would the corporate income tax need to be lowered to avoid a net tax increase on your company?**

   Response: In 2010, Chevron's effective tax rate in the U.S. was 31.5%.

   We believe that the U.S. federal income tax system should make the United States an attractive place to do business and should allow U.S.-based companies to effectively compete in the global marketplace. To do so, the U.S. tax system must be competitive with those of other countries. We see a growing consensus that the corporate tax rate should be lowered to preserve the global competitiveness of U.S. companies. To the extent that the tax base is expanded by reducing, eliminating or deferring tax deductions and credits, that burden should be shared broadly by all industries and categories of taxpayers. Changes should not disproportionately affect any single industry, nor should they favor one form of energy over another.

2. **While I support the ideas of individual and corporate tax reform, I am concerned that a dramatic change in our tax code will be problematic for companies and individuals who have done long term tax planning. Do you agree with my assessment that there needs to be a phase in period? If so, how long should that phase in period be? If not, please explain how your company would handle such a change in the tax code.**

   Response: A residence-based or worldwide system of taxation is currently utilized in the United States. A residence-based tax system allows a government to tax individuals and corporations on their worldwide income. The tax reform proposals being discussed include the residence-based or worldwide taxation system with an end to tax deferral for U.S. owned foreign corporations, and a territorial system.

   Without a specific proposal to analyze, we cannot comment on a phase-in period for tax reform. However, our planning involves longstanding tax provisions and their impact on long-term project outcomes, so that dramatic changes in tax law could be disruptive to

returns and investment plans. Chevron, like most companies, makes investment decisions based upon stable and predictable investment regimes.

3. **Are there any provisions of the tax code that you would prefer not be changed if we were to lower the corporate tax rate as a part of overall corporate tax reform?**

   Response: To the extent that the tax base is expanded by reducing, eliminating or deferring tax deductions and credits, that burden should be shared broadly by all industries and categories of taxpayers. Changes should be carefully scrutinized, and not disproportionately affect any single industry, nor should they favor one form of energy over another.

   The dual capacity foreign tax credit, which is available to all businesses, is designed to avoid taxing the same income earned overseas twice, once in the host country jurisdiction and again in the United States. Repealing this provision would place U.S-based companies at a competitive disadvantage with international-based companies, by subjecting them to double taxation on income earned overseas, making them less competitive internationally and costing the United States revenues and jobs that support overseas operations.

The Honorable Maria Cantwell

1. **The discussion of tax subsidies and incentives in the May 12, 2011 Finance Committee hearing was largely an abstract one on the overall economic and societal costs and benefits that result from these measures. I would appreciate having more specific information on the extent to which your firms have benefited from the tax provisions being discussed over the last decade. For your respective firms, would you please provide auditable data on your company's utilization of each of the following categories and for each of the past ten years (2000-2010):**

   - **Enhanced Oil Recovery Credit**
   - **Credit for Oil and Gas from Marginal Wells**
   - **Expensing of Intangible Drilling Costs**
   - **Deduction for Tertiary Injectants**
   - **Passive Loss Exception for Working Interests in Oil Properties**
   - **Percentage Depletion for Oil and Natural Gas Wells**
   - **Domestic Manufacturing Deduction for Oil and Natural Gas Companies**
   - **Geological and Geophysical Amortization**
   - **Net annual profit**

   Response: The annual totals and/or more detailed breakout of these expenses are proprietary business information, which we need to keep confidential for competitive reasons.

Percentage depletion taken on U.S. oil and natural gas production by integrated oil and natural gas companies, like Chevron, was repealed by Congress in 1975. The passive loss exception rules similarly do not apply to integrated oil and natural gas companies.

Chevron's Net Income from 2000-2010:

Net Income ($ Millions)										
2010	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**	**2001**	**2000**
19,024	10,483	23,931	18,688	17,138	14,099	13,328	7,230	1,132	3,288	7,727

2. **I think we can all agree that America's future prosperity and competitiveness is contingent on figuring out how we can live within our means while providing our businesses more predictability and stability in the marketplace, in part by providing a more level playing field for all market participants. I would argue that one thing we can do is to ensure that U.S. industries all receive equal treatment under the federal tax code so that they operate on an equal footing. I don't understand, for example, why oil companies should be allowed to write off the costs of machinery and other so-called "intangible costs" immediately, while companies in other industries have to write off these expenses gradually, over the lifetime of the equipment they purchase. Likewise, a few years ago, Congress to redefine the word "manufacturing" so that oil companies could take advantage of a manufacturing tax deduction for oil production.**

   I was intrigued by an argument that Mr. Watson made in his testimony, which if I understood him correctly, argued that we should not change tax breaks for the oil industry outside of a broader context of corporate tax reform.

   Does that mean that you might all be willing to work with Congress to figure out ways to simplify and reform our nation's byzantine tax code in the interest of replacing the myriad of tax expenditures we are discussing here today with lower overall corporate tax rates for all industries?

   Considering all the uncertainties that affect your industry and the United States as a whole, would you support efforts to create a policy framework which provides greater certainty and stability when it comes to energy prices, regulation, and supply and demand fundamentals? I believe that is an important question because eventually Congress will regulate greenhouse gas emissions. This moment may come as soon as next year if the DC Circuit throws out EPA's tailoring rule. Would your companies support be supportive of legislation that established a price on carbon in a manner that was transparent, market-based, technology and fuel neutral, and economy-wide, as an alternative to EPA regulation of greenhouse gases?

Response: We believe that the U.S. federal income tax system should make the United States an attractive place to do business and should allow U.S.-based companies to effectively compete in the global marketplace. To do so, the U.S. tax system must be competitive with those of other countries. We see a growing consensus that the corporate tax rate should be lowered to preserve the global competitiveness of US companies. To the extent that the tax base is expanded by reducing, eliminating or deferring tax deductions and credits, that burden should be shared broadly by all industries and categories of taxpayers. Changes should not disproportionately affect any single industry, nor should they favor one form of energy over another.

Chevron, like all companies, makes investment decisions based upon stable and predictable investment regimes. The U.S. corporate tax rate is already among the highest in the world. In addition, there have been a number of signals to the market that discourage investment in much-needed traditional oil and natural gas production. Additional, punitive or discriminatory taxes on the U.S. oil and natural gas industry are contrary to the goal of providing stable and cost-effective supplies of energy for U.S. consumers and discourage the tremendous capital investments needed to meet the nation's growing energy needs. Additional taxes discourage new domestic energy projects, thereby increasing our dependence on imported oil and products.

When companies drill for oil and natural gas they are effectively testing the target geologic horizon for hydrocarbons, even in known and existing fields. To do so, we incur intangible drilling costs, such as clearing land, labor, engineering and design. Similarly, other businesses are able to expense the costs of testing applications for revenue potential, such as research and development costs of the pharmaceutical industry or mine development costs of other extractive industries. Repealing the deduction would discourage domestic investment and likely result in less revenue to the government, fewer U.S. jobs and greater dependence on foreign oil.

Our collective challenge, if Congress reconsiders greenhouse gas (GHG) emissions legislation, is to create solutions that protect the environment without undermining the growth of the global economy. We offer the following seven principles as guideposts for the development of policies:

1. Global engagement: The reduction of GHGs must be shared equitably through long-term and coordinated national frameworks.
2. Energy security: Oil, coal and natural gas are expected to dominate energy supply for decades to come. Policies must recognize the role these critical energy sources play to ensure security of supply and economic growth.
3. Maximize conservation: Energy efficiency and conservation are the most immediate and cost-effective sources of "new" energy with no GHG emissions. Government programs to promote cost-effective energy efficiency and conservation must continue and should be enhanced.

4. Measured and flexible approach: GHG reduction objectives must avoid a disruptive economic impact and allow for realistic turnover of capital and a phase–in of new, lower-carbon technologies.
5. Broad, equitable treatment: Broad and equitable treatment of all sectors of the economy is necessary to ensure no sector or company is disproportionately burdened.
6. Enable technology: Government support and partnerships with the private sector for pre-competitive research and development in carbon mitigation and clean energy technologies must continue at an accelerated pace.
7. Transparency: The costs, risks, trade-offs and uncertainties associated with policies must be openly communicated.

3. **Both the Joint Economic Committee and the Congressional Research Service produced analyses that show that removing tax expenditures to the oil industry as proposed in S. 940 will not lead to significant gasoline price increases or oil production decreases. To you agree with conclusions of these reports? And if not, please describe in detail the flaw or flaws in their analyses. Are there any independent studies that demonstrate that eliminating these tax expenditures will significantly increase prices or reduce domestic oil and gas production?**

   Response: According to studies by Wood Mackenzie and Louisiana State University economist Dr. Joseph Mason, some of the tax proposals could reduce domestic production by as much as 600,000 barrels of oil equivalent per day; put an estimated $15 billion in capital at risk in 2011 alone and almost $130 billion over the next 10 years; put 165,000 jobs at risk in 2020; and reduce wages by $68 billion nationwide.

The Honorable Robert Menendez

1. **According to the Energy Information Administration, the average cost to produce a barrel of oil is around $33; but SEC filings show that the average production costs for the Big 5 are much lower, at about $11. With a barrel of oil selling for around $100, why do you need subsidies? Can each of you tell the Committee and the American people what price per barrel and profit margin you will need to reach before these subsidies are no longer necessary?**

   Response: We believe that longstanding provisions in the tax code should not be characterized as subsidies. For all firms in the United States, a basic tax principal is that they are taxed on net income after costs. All companies in all sectors – large or small – may deduct these costs in various ways. Eliminating these provisions will result in less capital available for new investments which develop new energy supplies, reducing U.S. oil and gas production, energy security and U.S. jobs. For example, the discriminatory elimination of the dual capacity foreign tax credit would subject U.S. based oil and gas companies to double taxation on income earned overseas, making us less competitive internationally and costing the United States revenues and jobs that support our overseas operations.

We continue to advocate for the sharing of the burden by all industries and categories of taxpayers. Changes should not disproportionately affect any single industry, nor should they favor one form of energy over another.

2. **Please provide a detailed accounting of how many dollars your company did not pay in taxes as a result of the tax subsidies proposed to be eliminated in S.940, the Close Big Oil Tax Loopholes Act, for each of the last 5 years.**

Response: The items listed in S.940 are not subsidies. The items in S.940 permit recovery of investment in arriving at net taxable income and provide a foreign tax credit to prevent double taxation of foreign income. The breakout of these expenses is proprietary business information, which we need to keep confidential for competitive reasons.

Attachment I

Executive compensation information extracted from Chevron Notices of Annual Meetings and Proxy Statements

(Also available at: http://www.chevron.com/investors/financialinformation/)

Executive Compensation *(Continued)*

SUMMARY COMPENSATION TABLE

The following table sets forth the compensation of our named executive officers, or "NEOs," for the fiscal year ending December 31, 2010, and for the fiscal years ending December 31, 2009 and 2008, if they were NEOs in those years. The primary components of each NEO's compensation are also described in our "Compensation Discussion and Analysis," above. Our NEOs do not have employment contracts with the Company, except for Mr. Pate and Mr. James. Their employment arrangements are discussed in our "Compensation Discussion and Analysis—Part III—Employment, Severance or Change-in-Control Agreements," above, and in "Potential Payments Upon Termination or Change-in-Control," below.

Name and Principal Position(1)	Year	Salary ($)(2)	Stock Awards ($)(3)	Option Awards ($)(4)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(6)	All Other Compensation ($)(7)	Total ($)
J.S. Watson, Chairman and CEO	2010	$1,479,167	$3,752,400	$5,535,200	$3,000,000	$2,273,265	$ 220,496	$16,260,528
	2009	$ 946,042	$2,382,730	$2,611,200	$1,200,000	$1,553,664	$ 99,055	$ 8,792,691
	2008	$ 800,417	$1,734,600	$1,788,640	$ 975,000	$ 157,861	$ 79,239	$ 5,535,757
P.E. Yarrington, Chief Financial Officer	2010	$ 776,667	$1,486,800	$2,197,800	$1,050,000	$1,273,493	$ 62,133	$ 6,846,893
	2009	$ 707,708	$1,728,070	$1,996,800	$ 700,000	$1,154,130	$ 59,170	$ 6,345,878
G.L. Kirkland, Vice Chairman & Executive Vice President	2010	$1,191,667	$2,124,000	$3,093,200	$2,150,000	$3,686,572	$ 116,603	$12,362,042
	2009	$ 946,042	$2,382,730	$2,611,200	$1,260,000	$2,851,301	$ 94,648	$10,145,921
	2008	$ 800,417	$1,734,600	$1,788,640	$1,070,000	$1,127,469	$ 81,465	$ 6,602,591
M.K. Wirth, Executive Vice President	2010	$ 896,667	$2,533,340	$2,197,800	$1,250,000	$ 862,826	$ 119,257	$ 7,859,890
R.H. Pate, Vice President & General Counsel	2010	$ 681,167	$1,132,800	$1,660,560	$ 850,000	$ 61,387	$ 90,205	$ 4,476,119
C.A. James, (former) Executive Vice President	2010	$ 303,713	$1,486,800 (8)	$2,197,800 (9)	$ 350,000	$ 423,942	$2,067,023	$ 6,829,278
	2009	$ 794,875	$4,557,890	$1,996,800	$ 775,000	$ 592,331	$ 74,158	$ 8,791,054

(1) Mr. James retired from Chevron in May 2010.

(2) Reflects actual salary earned during the fiscal year covered. Compensation is reviewed after the end of each year, and salary increases, if any, are generally effective April 1 of the following year. 2010 increases for Messrs. Watson and Kirkland were effective in January 2010 concurrent with their promotions to Chairman and Vice Chairman. The 2010 increase for Mr. Wirth was effective in January 2010 following a separate review of his compensation by the Management Compensation Committee that coincided with other leadership changes. The table below reflects the annual salary rate and effective date for the years in which each person was an NEO and the amounts deferred under the Deferred Compensation Plan for Management Employees (DCP). The salaries below for Messrs. Watson, Kirkland and Wirth, effective January 1, 2010, differ from the amounts reported above because the table above reflects actual amounts paid and/or deferred in 2010, and salary for the last half of December 2009 (at a different rate) was paid and/or deferred in January 2010.

Executive Compensation *(Continued)*

SUMMARY COMPENSATION TABLE

The following table sets forth the compensation of our named executive officers, or "NEOs," for the fiscal year ending December 31, 2009, and for the fiscal years ending December 31, 2008 and 2007 for Messrs. O'Reilly, Watson, and Kirkland, who were NEOs in 2008 and 2007. The primary components of each NEO's compensation are also described in our Compensation Discussion and Analysis, above. Our NEOs do not have employment contracts with the Company, except for Mr. James. His employment arrangement is discussed in our "Compensation Discussion and Analysis—Part III—Employment, Severance or Change-in-Control Agreements," above, and in "Potential Payments Upon Termination or Change-in-Control," below.

Name and Principal Position(1)	Year	Salary ($)(2)	Stock Awards ($)(3)	Option Awards ($)(4)	Non-Equity Incentive Plan Compensation(5)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(6)	All Other Compensation ($)(7)	Total ($)
D.J. O'Reilly,	2009	$1,793,750	$5,069,450 (8)	$4,838,400 (9)	$3,000,000	$1,331,917	$517,228	$16,550,745
Chairman and CEO	2008	$1,650,000	$4,262,160	$4,391,750	$3,220,000	$1,046,734	$266,884	$14,837,528
	2007	$1,650,000	$4,511,240	$5,726,250	$3,600,000	$ 0	$255,251	$15,742,741
P.E. Yarrington, Chief Financial Officer	2009	$ 707,708	$1,728,070	$1,996,800	$ 700,000	$1,154,130	$ 59,170	$ 6,345,878
J.S. Watson,	2009	$ 946,042	$2,382,730	$2,611,200	$1,200,000	$1,553,664	$ 99,055	$ 8,792,691
Vice Chairman	2008	$ 800,417	$1,734,600	$1,788,640	$ 975,000	$ 157,861	$ 79,239	$ 5,535,757
	2007	$ 746,042	$1,555,600	$1,908,750	$1,050,000	$ 0	$100,260	$ 5,360,652
G.L. Kirkland,	2009	$ 946,042	$2,382,730	$2,611,200	$1,260,000	$2,851,301	$ 94,648	$10,145,921
Executive Vice President	2008	$ 800,417	$1,734,600	$1,788,640	$1,070,000	$1,127,469	$ 81,465	$ 6,602,591
	2007	$ 746,042	$1,555,600	$1,908,750	$1,050,000	$ 662,309	$ 76,303	$ 5,999,004
C.A. James, Executive Vice President	2009	$ 794,875	$4,557,890	$1,996,800	$ 775,000	$ 592,331	$ 74,158	$ 8,791,054

(1) Mr. O'Reilly retired on December 31, 2009. Following his retirement, Mr. Watson became Chairman and CEO and Mr. Kirkland became Vice Chairman.

(2) Reflects actual salary earned during the fiscal year covered. Compensation is reviewed after the end of each year, and salary increases, if any, are effective April 1 of the following year. The table below reflects the salary effective April 1 of the year in which each person was an NEO and the amounts deferred under the Deferred Compensation Plan for Management Employees (DCP). For Mr. O'Reilly, salary paid in 2009 exceeds that in the table below because his pay for the last half of December, which normally would be paid in January 2010, was paid in December as a result of his retirement and in accordance with California labor law.

Name	Year	Salary Effective April 1	Salary Deferred Under the DCP
D.J. O'Reilly	2009	$1,750,000	$756,875
	2008	$1,650,000	$660,000
	2007	$1,650,000	$660,000
P.E. Yarrington	2009	$ 720,000	$283,083
J.S. Watson	2009	$1,000,000	$ 14,021
	2008	$ 815,000	$ 11,408
	2007	$ 765,000	$ 10,421
G.L. Kirkland	2009	$1,000,000	$ 14,021
	2008	$ 815,000	$ 11,408
	2007	$ 765,000	$ 10,421
C.A. James	2009	$ 801,000	$ 10,998

We explain the amount of salary in proportion to total compensation in our "Compensation Discussion and Analysis—Part II—Allocation Among Components," above.

Executive Compensation *(Continued)*

SUMMARY COMPENSATION TABLE

The following table sets forth the compensation of our named executive officers, or "NEOs," for the fiscal years ending December 31, 2008, 2007 and 2006. None of our NEOs has an employment contract with the Company. The primary components of each NEO's compensation are also described in our Compensation Discussion and Analysis, above.

Name and Principal Position	Year	Salary ($)(1)	Stock Awards ($)(2)	Option Awards ($)(3)	Non-Equity Incentive Plan Compensation(4)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(5)	All Other Compensation ($)(6)	Total ($)
D.J. O'Reilly, Chairman and CEO	2008	$ 1,650,000	$ 8,079,218	$ 5,008,413	$3,220,000	$1,046,734	$266,884	$ 19,271,249
	2007	$ 1,650,000	$ 19,387,350	$ 6,650,584	$3,600,000	$ 0	$255,251	$ 31,543,185
	2006	$ 1,620,833	$ 13,008,715	$ 6,922,146	$3,500,000	$6,322,578	$228,617	$ 31,602,889
S.J. Crowe, Chief Financial Officer	2008	$ 699,583	$ 2,587,013	$ 1,878,527	$ 825,000	$1,424,527	$ 75,226	$ 7,489,876
	2007	$ 628,125	$ 4,204,525	$ 1,865,439	$ 875,000	$1,384,104	$ 66,522	$ 9,023,715
	2006	$ 553,125	$ 1,931,712	$ 1,224,583	$ 750,000	$1,514,768	$ 61,986	$ 6,036,174
P.J. Robertson, Vice Chairman	2008	$ 1,035,417	$ 4,058,454	$ 2,572,276	$1,350,000	$ 645,041	$114,092	$ 9,775,280
	2007	$ 985,417	$ 8,476,531	$ 2,950,296	$1,500,000	$ 119,935	$136,143	$ 14,168,322
	2006	$ 935,417	$ 5,544,890	$ 2,946,302	$1,500,000	$3,215,273	$118,723	$ 14,260,605
G.L. Kirkland, Executive Vice President	2008	$ 800,417	$ 4,611,462	$ 2,919,356	$1,070,000	$1,127,469	$ 81,465	$ 10,610,169
	2007	$ 746,042	$ 4,577,194	$ 1,539,819	$1,050,000	$ 662,309	$ 76,303	$ 8,651,667
	2006	$ 679,583	$ 2,303,245	$ 1,158,095	$1,000,000	$1,688,917	$ 72,428	$ 6,902,268
J.S. Watson, Executive Vice President	2008	$ 800,417	$ 3,283,279	$ 1,691,099	$ 975,000	$ 157,861	$ 79,239	$ 6,986,895
	2007	$ 746,042	$ 4,675,957	$ 1,306,593	$1,050,000	$ 0	$100,260	$ 7,878,852
	2006	$ 685,417	$ 2,844,431	$ 1,206,416	$1,000,000	$ 834,565	$ 70,756	$ 6,641,585

(1) Compensation is reviewed after the end of each year, and salary increases, if any, are effective April 1 of the following year. The table below reflects the salary effective April 1, 2008, 2007 and 2006 for each of the NEOs and the amounts earned and deferred under the Deferred Compensation Plan for Management Employees (DCP).

Name	Year	Salary Effective April 1	Salary Deferred Under the DCP
D.J. O'Reilly	2008	$1,650,000	$660,000
	2007	$1,650,000	$660,000
	2006	$1,650,000	$630,250
S.J. Crowe	2008	$ 720,000	$279,833
	2007	$ 650,000	$251,250
	2006	$ 575,000	$221,250
P.J. Robertson	2008	$1,050,000	$ 38,421
	2007	$1,000,000	$ 15,208
	2006	$ 950,000	$ 14,308
G.L. Kirkland	2008	$ 815,000	$ 11,408
	2007	$ 765,000	$ 10,421
	2006	$ 700,000	$ 9,192
J.S. Watson	2008	$ 815,000	$ 11,408
	2007	$ 765,000	$ 10,421
	2006	$ 700,000	$ 9,308

We explain the amount of salary in proportion to total compensation in "Allocation Among Components" in our Compensation Discussion and Analysis.

(2) 2008 amounts include the aggregate proportionate fair value for (a) performance shares granted under the Corporation's Long-Term Incentive Plan in four grant years (2008, 2007, 2006 and 2005) and (b) restricted stock units granted under the LTIP on June 25, 2003, that have been recognized as compensation costs in our financial statements for the fiscal year ended December 31, 2008, under Financial Accounting Standards Board Statement of Financial Accounting Standards (FAS) No. 123 (revised 2004), Share-Based Payment (FAS 123R). For purposes of this table only, estimates of forfeitures related to service-based vesting conditions have been disregarded.

Executive Compensation *(Continued)*

SUMMARY COMPENSATION TABLE

The following table sets forth the compensation of our named executive officers, or "NEOs," for the fiscal years ending December 31, 2007, and December 31, 2006. None of our NEOs has an employment contract with the Company. The primary components of each NEO's compensation are also described in our Compensation Discussion and Analysis, above.

Name and Principal Position	Year	Salary ($)(1)	Stock Awards ($)(2)	Option Awards ($)(3)	Non-Equity Incentive Plan Compensation(4)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(5)	All Other Compensation ($)(6)	Total ($)
D.J. O'Reilly, Chairman and CEO	2007	$ $1,650,000	$ $19,387,350	$ $6,650,584	$ $ 3,600,000	$ $0 6,322,578	$ $ 255,251	$ $31,543,185
	2006	1,620,833	13,008,715	6,922,146	3,500,000		228,617	31,602,889
S.J. Crowe, Chief Financial Officer	2007	$ $628,125	$ $4,204,525	$ $1,865,439	$ $ 875,000	$ $ 1,384,104	$ $ 66,522	$ $9,023,715
	2006	553,125	1,931,712	1,224,583	750,000	1,514,768	61,986	6,036,174
P.J. Robertson, Vice Chairman	2007	$ $985,417	$ $8,476,531	$ $2,950,296	$ $ 1,500,000	$ $ 119,935	$ $ 136,143	$ $14,168,322
	2006	935,417	5,544,890	2,946,302	1,500,000	3,215,273	118,723	14,260,605
G.L. Kirkland, Executive Vice President	2007	$ $746,042	$ $4,287,145	$ $1,539,819	$ $ 1,050,000	$ $ 662,309	$ $ 76,303	$ $8,361,618
	2006	679,583	2,303,245	1,158,095	1,000,000	1,688,917	72,428	6,902,268
J.S. Watson, Executive Vice President	2007	$ $746,042	$ $4,675,957	$ $1,306,593	$ $ 1,050,000	$ $ 0 834,565	$ $ 100,260	$ $7,878,852
	2006	685,417	2,844,431	1,206,416	1,000,000		70,756	6,641,585

(1) Compensation is reviewed after the end of each year, and salary increases, if any, are effective April 1 of the following year. The table below reflects the salary effective April 1, 2006 and 2007, for each of the NEOs and the amounts earned and deferred under the Deferred Compensation Plan for Management Employees (DCP).

Name	Year	Salary Effective April 1	Salary Deferred Under the DCP
D.J. O'Reilly	2007	$ 1,650,000	$ 660,000
	2006	$ 1,650,000	$ 630,250
S.J. Crowe	2007	$ 650,000	$ 251,250
	2006	$ 575,000	$ 221,250
P.J. Robertson	2007	$ 1,000,000	$ 15,208
	2006	$ 950,000	$ 14,308
G.L. Kirkland	2007	$ 765,000	$ 10,421
	2006	$ 700,000	$ 9,192
J.S. Watson	2007	$ 765,000	$ 10,421
	2006	$ 700,000	$ 9,308

(2) 2007 amounts include the aggregate proportionate fair value for (a) performance shares granted under the Corporation's Long-Term Incentive Plan in four grant years (2007, 2006, 2005 and 2004) and (b) restricted stock units granted under the LTIP on June 25, 2003, that have been recognized as compensation costs in our financial statements for the fiscal year ended December 31, 2007 under Financial Accounting Standards Board Statement of Financial Accounting Standards (FAS) No. 123 (revised 2004), Share-Based Payment (FAS 123R).

Executive Compensation *(Continued)*

SUMMARY COMPENSATION TABLE

The following sets forth the compensation of the Company's named executive officers in the fiscal year ended December 31, 2006. None of our named executive officers has an employment contract with the Company.

Name and Principal Position	Year	Salary ($)(1)	Stock Awards ($)(2)	Option Awards ($)(3)	Non-Equity Incentive Plan Compensation(4)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(5)	All Other Compensation ($)(6)	Total ($)
D. J. O'Reilly, Chairman and CEO	2006	$ 1,620,833	$ 13,008,715	$ 6,922,148	$ 3,500,000	$ 6,322,578	$ 228,617	$31,602,889
S. J. Crowe, Chief Financial Officer	2006	$ 553,125	$ 1,931,712	$ 1,224,583	$ 750,000	$ 1,514,768	$ 61,986	$ 6,036,174
P. J. Robertson, Vice Chairman	2006	$ 935,417	$ 5,544,890	$ 2,946,302	$ 1,500,000	$ 3,215,273	$ 118,723	$14,260,605
G. L. Kirkland, Executive Vice President	2006	$ 678,583	$ 2,303,245	$ 1,158,095	$ 1,000,000	$ 1,688,917	$ 72,428	$ 6,902,268
J. S. Watson, Vice President	2006	$ 685,417	$ 2,844,431	$ 1,206,416	$ 1,000,000	$ 834,565	$ 70,756	$ 6,641,585

(1) Reflects salary earned in 2006, including salary deferred under the Deferred Compensation Plan for Management Employees, which, for 2006, was: D. J. O'Reilly, $630,250; S. J. Crowe, $221,250; P. J. Robertson, $14,308; G. L. Kirkland, $9,192; J. S. Watson, $9,308. Compensation is reviewed after the end of each year and salary increases, if any, are effective April 1 of the following year. The salary effective on April 1, 2006 for each of the named executive officers was as follows: D. J. O'Reilly, $1,650,000; S. J. Crowe, $575,000; P. J. Robertson, $950,000; G. L. Kirkland, $700,000; J. S. Watson, $700,000.

(2) Amounts include the aggregate proportionate fair value for performance shares granted under the Corporation's Long-Term Incentive Plan (LTIP) in four grant years (2006, 2005, 2004 and 2003) that have been recognized as compensation costs for financial reporting purposes for the fiscal year ended December 31, 2006, and do not represent the grant date fair value of performance shares granted in 2006. The grant date fair value for performance shares granted in 2006 as reported on the "Grants of Plan-Based Awards" table below for each of the named executive officers is as follows: D. J. O'Reilly, $3,034,880; S. J. Crowe, $569,040; P. J. Robertson, $1,280,340; G. L. Kirkland, $948,400; J. S. Watson, $948,400. The "Grants of Plan-Based Awards" table also provides a detailed description of the performance shares. The following number of performance shares were granted in 2006, 2005, 2004 and 2003, respectively: D. J. O'Reilly, 64,000, 66,000, 106,000 and 106,000; S. J. Crowe, 12,000, 13,000, 9,000 and 9,000; P. J. Robertson, 27,000, 28,000, 40,000 and 40,000; G. L. Kirkland, 20,000, 18,000, 18,000 and 18,000; J. S. Watson, 20,000, 18,000, 27,000 and 27,000.

Performance shares result in a payout only if, at the end of the three-year performance period, the Corporation achieves a certain Total Stockholder Return (TSR) for the performance period as compared to the TSR of each company in the Corporation's peer group. Amounts in this column were determined under Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS 123R) for financial reporting purposes. Under the provisions of FAS 123R, performance shares are classified as liability awards. Accordingly, total per-share compensation cost equals the payout amount measured as of the settlement date at the end of the 3-year performance period. Until settlement, compensation costs recorded in the Company's financial statements recognize changes in estimated fair value as of the end of each quarterly reporting period. The Company uses a Monte Carlo approach to calculate estimated fair value of performance shares. To derive estimated fair value per share, this valuation technique simulates TSR for the Company and the peer group using market data for a period equal to the term of the performance period, correlates the simulated returns within the peer group to estimate a probable payout value, and discounts the probable payout value using a risk-free rate for Treasury bonds having a term equal to the performance period. As of December 31, 2006, this technique generated estimated fair values per share of $95.57, $101.20, and $81.21 for the outstanding 2006, 2005 and 2004 grants, respectively. The settlement value for the 2003 grant was $58.88 per share. Since the performance period for the 2003 grant ended in 2006, each performance share under the 2003 grant was further adjusted by the actual performance modifier of 125 percent.

Amounts in this column also include the proportionate amount of fair value of the restricted stock units granted under the LTIP on June 25, 2003 that have been recognized as compensation costs in the Company's financial statement for 2006 and the aggregate dividend accrual in 2006 to be paid at vesting. The value of each restricted stock unit is $36.70, which is based on the closing price of Chevron Stock on the date of the grant. The number of restricted stock units granted in 2003 were: P. J. Robertson 31,000; G. L. Kirkland 13,000; J. S. Watson 24,000. Fifty percent will vest on June 25, 2007, and the

Executive Compensation

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation			All Other Compensation(4) ($)
					Awards		Payouts	
		Salary ($)	Bonus (Year Earned) ($)	Other Compensation(1) ($)	Restricted Stock Unit Awards(2) ($)	Securities Underlying Options(3) (#)	Vested Performance Units ($)	
D.J. O'Reilly Chairman	2005	$ 1,550,000	$ 3,500,000	$ 51,083	—	425,000	$ 3,575,250	$ 124,000
	2004	$ 1,506,250	$ 3,950,000	$ 84,714	—	460,000	$ 841,120	$ 120,500
	2003	$ 1,312,500	$ 3,150,000	—	—	460,000	$ 3,255,200	$ 105,000
P.J. Robertson Vice-Chairman	2005	$ 879,583	$ 1,500,000	—	—	180,000	$ 1,532,250	$ 70,367
	2004	$ 806,667	$ 1,575,000	—	—	200,000	$ 328,563	$ 64,533
	2003	$ 723,750	$ 1,365,000	—	$ 1,137,700	200,000	$ 712,075	$ 57,900
P.A. Woertz Executive Vice President	2005	$ 685,417	$ 850,000	—	—	115,000	$ 825,713	$ 54,833
	2004	$ 635,417	$ 1,210,000	—	—	120,000	$ 254,965	$ 50,833
	2003	$ 585,417	$ 945,000	—	$ 880,800	120,000	$ 712,075	$ 45,833
J.S. Watson Vice President	2005	$ 635,417	$ 1,000,000	—	—	115,000	$ 825,713	$ 50,833
	2004	$ 576,667	$ 1,155,000	—	—	120,000	$ 183,995	$ 46,133
	2003	$ 502,500	$ 945,000	—	$ 880,800	120,000	$ 712,075	$ 40,200
G.L. Kirkland Executive Vice President	2005	$ 618,750	$ 1,000,000	—	—	115,000	$ 595,875	$ 49,500
	2004	$ 519,583	$ 945,000	—	—	90,000	$ 183,995	$ 41,567
	2003	$ 456,875	$ 787,500	—	$ 477,100	90,000	$ 528,970	$ 36,550

(1) For security reasons, D.J. O'Reilly uses company aircraft for both business and personal travel when judged appropriate. Included for D.J. O'Reilly is $27,551 for 2005 and $61,716 for 2004 for his personal use of company aircraft based on estimated incremental costs to the Company. Also included for D.J. O'Reilly is $20,700 for 2005 for financial counseling services.

(2) As of December 31, 2005, the aggregate number of restricted stock units held by the named officers are as follows: P.J. Robertson, 33,592 with an aggregate market value of $1,907,036; P.A. Woertz, 26,007 with an aggregate market value of $1,476,415; J.S. Watson, 26,007 with an aggregate market value of $1,476,415; G.L. Kirkland, 14,087 with an aggregate market value of $799,725.

On June 25, 2003, the named officers received the following restricted stock unit awards (adjusted for the September 10, 2004 two-for-one stock split); P.J. Robertson, 31,000 units; P.A. Woertz, 24,000 units; J.S. Watson, 24,000 units and G.L. Kirkland, 13,000 units. Fifty percent of the units subject to the award will be vested on the fourth anniversary of the grant date and 50 percent will be vested on the eighth anniversary of the grant date.

Dividend equivalents are paid on the restricted stock units and are converted into additional restricted stock units as of the dividend payment date.

(3) The number of securities underlying stock options has been adjusted for the Company's September 10, 2004 two-for-one stock split.

(4) Includes Chevron's contributions to the Employee Savings Investment Plan and allocations under the Employee Savings Investment Plan Restoration Plan. For 2005, contributions under the Employee Savings Investment Plan were $16,800 for each of the named individuals. Contributions under the ESIP Restoration Plan for the named individuals were as follows: D.J. O'Reilly, $107,200; P.J. Robertson, $53,567; P.A. Woertz, $38,033; J.S. Watson, $34,033; G.L. Kirkland, $32,700.

Executive Compensation

SUMMARY COMPENSATION TABLE

					Long-Term Compensation			
		Annual Compensation			Awards		Payouts	
Name and Principal Position	Year	Salary ($)	Bonus (Year Earned) ($)	Other Compensation (1) ($)	Restricted Stock Unit Awards (2) ($)	Securities Underlying Options (3) (#)	Vested Performance Shares ($)	All Other Compensation (4) ($)
D. J. O'Reilly Chairman	2004	$ 1,506,250	$ 3,950,000	$ 84,714	—	460,000	$ 841,120	$ 120,500
	2003	$ 1,312,500	$ 3,150,000	—	—	460,000	$ 3,255,200	$ 105,000
	2002	$ 1,075,000	$ 700,000	—	—	400,000	$ 2,154,240	$ 81,209
P. J. Robertson Vice-Chairman	2004	$ 806,667	$ 1,575,000	—	—	200,000	$ 328,563	$ 64,533
	2003	$ 723,750	$ 1,365,000	—	$ 1,137,700	200,000	$ 712,075	$ 57,900
	2002	$ 615,000	$ 425,000	—	—	160,000	$ 471,240	$ 46,112
P. A. Woertz Executive Vice President	2004	$ 635,417	$ 1,210,000	—	—	120,000	$ 254,965	$ 50,833
	2003	$ 585,417	$ 945,000	—	$ 880,800	120,000	$ 712,075	$ 46,833
	2002	$ 543,750	$ 275,000	—	—	91,000	$ 471,240	$ 41,072
J. S. Watson Vice President	2004	$ 576,667	$ 1,155,000	—	—	120,000	$ 183,995	$ 46,133
	2003	$ 502,500	$ 945,000	—	$ 880,800	120,000	$ 712,075	$ 40,200
	2002	$ 450,000	$ 350,000	—	—	91,000	$ 175,032	$ 32,524
G. L. Kirkland Vice President	2004	$ 519,583	$ 945,000	—	—	90,000	$ 183,995	$ 41,567
	2003	$ 456,875	$ 787,500	—	$ 477,100	90,000	$ 528,970	$ 36,550
	2002	$ 418,750	$ 264,000	—	—	66,000	$ 418,750	$ 31,261

(1) For security reasons, D. J. O'Reilly uses company aircraft for both business and personal travel. Included for 2004 is $61,716 for his personal use of company aircraft based on estimated incremental costs to the Company.

(2) As of December 31, 2004, the aggregate number of restricted stock units held by the named officers are as follows: P. J. Robertson, 32,628 with an aggregated market value of $1,713,272; P. A. Woertz, 25,260 with an aggregate market value of $1,326,404; J. S. Watson, 25,260 with an aggregate market value of $1,326,404; G. L. Kirkland, 13,683 with an aggregate market value of $718,469.

On June 25, 2003, the named officers received the following restricted stock unit awards: P. J. Robertson, 31,000 units; P. A. Woertz, 24,000 units; J. S. Watson, 24,000 units and G. L. Kirkland, 13,000 units. 50 percent of the units subject to the award will be vested on the fourth anniversary of the grant date and 50 percent will be vested on the eighth anniversary of the grant date.

Dividend equivalents are paid on the restricted stock units and are converted into additional restricted stock units as of the dividend payment date.

The number of restricted stock units has been adjusted for the Company's September 10, 2004 two-for-one stock split.

(3) The number of securities underlying stock options has been adjusted for the Company's September 10, 2004 two-for-one stock split.

(4) Includes ChevronTexaco's contributions to the Employee Savings Investment Plan and allocations under the ESIP Restoration Plan for the Employee Savings Investment Plan. For 2004, contributions under the Employee Savings Investment Plan were $16,400 for each of the named individuals. Contributions under the ESIP Restoration Plan for the named individuals were as follows: D. J. O'Reilly, $104,100; P. J. Robertson, $48,133; P. A. Woertz, $34,433; J. S. Watson, $29,733 and G. L. Kirkland, $25,167.

EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE

		Annual Compensation		Long-Term Compensation: Awards		Long-Term Compensation: Payouts	
Name and Principal Position	Year	Salary ($)	Bonus (Year Earned) (3) ($)	Restricted Stock Unit Awards (1) ($)	Securities Underlying Options (#)	Vested Performance Shares ($)	All Other Compensation (2) ($)
D. J. O'Reilly	2003	$ 1,312,500	$ 3,150,000	—	230,000	$ 3,255,200	$ 105,000
Chairman	2002	$ 1,075,000	$ 700,000	—	200,000	$ 2,154,240	$ 81,209
	2001	$ 970,833	$ 5,000,000	—	150,000	$ 1,143,581	$ 141,853
P. J. Robertson	2003	$ 723,750	$ 1,365,000	$ 1,137,700	100,000	$ 712,075	$ 57,900
Vice-Chairman	2002	$ 615,000	$ 425,000	—	80,000	$ 471,240	$ 46,112
	2001	$ 519,167	$ 1,150,000	—	60,000	$ 640,406	$ 73,914
P. A. Woertz	2003	$ 585,417	$ 945,000	$ 880,800	60,000	$ 712,075	$ 46,833
Executive Vice President	2002	$ 543,750	$ 275,000	—	45,500	$ 471,240	$ 41,072
	2001	$ 487,292	$ 1,128,000	—	45,500	$ 640,406	$ 67,896
G. L. Kirkland	2003	$ 456,875	$ 787,500	$ 477,100	45,000	$ 528,970	$ 36,550
Vice President	2002	$ 418,750	$ 264,000	—	33,000	$ 418,750	$ 31,261
	2001	$ 345,000	$ 836,000	—	33,000	$ 155,527	$ 54,480
J. S. Watson	2003	$ 502,500	$ 945,000	$ 880,800	60,000	$ 712,075	$ 40,200
Vice President	2002	$ 450,000	$ 350,000	—	45,500	$ 175,032	$ 32,524
	2001	$ 405,417	$ 2,000,000	—	33,000	$ 237,865	$ 54,480

(1) As of December 31, 2003, the aggregate number of restricted stock units held by the named officers are as follows: Peter Robertson, 15,807 with an aggregated market value of $1,365,567; Patricia Woertz, 12,238 with an aggregate market value of $1,057,241; George Kirkland, 6,628 with an aggregate market value of $572,593; John Watson, 12,238 with an aggregate market value of $1,057,241. Dividend equivalents are paid on the restricted stock units and are converted into additional restricted stock units as of the dividend payment date.

(2) Includes ChevronTexaco's contributions to the Employee Savings Investment Plan and allocations under the Excess Benefit Plan for the Employee Savings Investment Plan. For 2003, contributions under the Employee Savings Investment Plan were $16,000 for each of the named individuals. Contributions under the Excess Benefit Plan for the named individuals were as follows: D. J. O'Reilly, $89,000; P.J. Robertson, $41,900; P. A. Woertz, $30,833; G. L. Kirkland, $20,550; and J. S. Watson, $24,200.

(3) 2001 amounts include regular annual bonus amounts as follows: D. J. O'Reilly, $1,800,000; P. J. Robertson, $650,000; P. A. Woertz, $628,000; G. L. Kirkland, $336,000; and J. S. Watson, $500,000. In addition, the ChevronTexaco Management Compensation Committee of the Board of Directors recognized exemplary performance related to the successful merger of Chevron and Texaco. They granted special one-time supplemental cash awards that will not be benefits bearing for retirement plan purposes as follows: D. J. O'Reilly, $3,200,000; P. J. Robertson, $500,000; P. A. Woertz, $500,000; G. L. Kirkland, $500,000; and J. S. Watson, $1,500,000.

LONG-TERM INCENTIVE PLAN – 2003 PERFORMANCE SHARES AWARDS TABLE

			Estimated Future Payout		
Name	Number of Performance Shares Granted	Performance Period Until Payout	Threshold	Target	Maximum
D. J. O'Reilly	53,000	3 Years	26,500	53,000	106,000
P. J. Robertson	20,000	3 Years	10,000	20,000	40,000
P. A. Woertz	13,500	3 Years	6,750	13,500	27,000
G. L. Kirkland	9,000	3 Years	4,500	9,000	18,000
J. S. Watson	13,500	3 Years	6,750	13,500	27,000

The payout can vary depending on ChevronTexaco TSR vs. its peer group competitors. A performance modifier provides the incentive to maximize TSR relative to the competitor peer group by modifying the payout value (e.g., the modifier is 200% for the highest relative TSR and 0% for the lowest relative TSR). Payout (in dollars) is equal to the number of shares times a performance modifier based on relative TSR times the 20-day trailing average price of ChevronTexaco Stock at the end of the performance period. The threshold represents the lowest payout unless the modifier is 0%, which will result in no payout.

Responses Submitted by Chevron to Follow-up Questions
From the May 12, 2011 hearing by the
Senate Finance Committee

The Honorable Tom A. Coburn, MD

1. **In light of the budget crisis our country faces, would your company be willing to take a cut to help the country?**

   Response: We believe that the most important contribution that Chevron can make to deficit reduction is to expand U.S. oil and natural gas production with the attendant increases in jobs created; revenues that flow to local, state and federal treasuries; and increased supplies that can help to moderate energy prices. Over the past few years, Chevron has made investments to develop U.S. and international energy resources which exceed our annual earnings. In 2011 alone, our capital and exploratory budget is estimated at $26 billion.

   Chevron recognizes the hardship caused by rising energy costs on American families as well as the broader impact higher energy costs have on the U.S. economy. The role of Chevron and the petroleum industry is to search for, develop and produce new and increased energy supplies that benefit all Americans. Additional, punitive or discriminatory taxes on the U.S. oil and natural gas industry are contrary to the goal of providing stable and cost-effective supplies of energy for U.S. consumers and discourage the tremendous capital investments needed to meet the nation's growing energy needs.

2. **Would you be willing to forgo each of the industry's tax advantages altogether if the following were true:**

A. **Federal assistance for alternative energy was also eliminated to ensure true competition among technologies;**
B. **The corporate tax rate for all industries was reduced to establish a competitive business environment?**
C. **Energy companies were allowed to fully access our nation's extensive natural resource deposits – including in ANWR, the Outer continental Shelf, the Gulf of Mexico, and the various shale plays across the country;**
D. **The regulatory process for energy leasing was streamlined – particularly as it relates to environmental permitting?**

   Response: Chevron has publicly stated that it supports broader corporate tax reform with the goal of creating a more attractive investment environment for U.S. energy investment. We have also stated that we believe that existing tax provisions for the U.S. oil and natural gas industry would need to be considered as part of the broader debate on corporate tax reform. We do not believe it's appropriate to link punitive tax increases on our industry to expanded access to federal lands. The two policy issues should be considered independent of each other and on their own merits.

   We see a growing consensus that the corporate tax rate should be lowered to preserve the global competitiveness of U.S. companies. To the extent that the tax base is expanded by reducing, eliminating or deferring tax deductions and credits, that burden should be shared

broadly by all industries and categories of taxpayers. Changes should not disproportionately affect any single industry, nor should they favor one form of energy over another.

3. **The American Petroleum Institute estimates the 9.2 million employees in the oil and gas industry earn over $90,000 per year (upstream and downstream job average – not including retail station sales). One of the nation's largest independents employing over 5,000 pays its employees: (1) $176,000 per year for engineers, geologists, etc.; (2) $138,000 per year for professional staff, such as accountants, human resources, etc.; and (3) $52,000 per year for clerical and administrative staff.**

   What is the average salary for your employees?

   Response: In 2010, the average base salary for Chevron's U.S. employees was $116,000, compared with the U.S. annual mean wage of all-occupations of approximately $45,000.

4. **What are the three things Congress can do to lower gas prices?**

   Response: Create energy and tax policies that make our country a more attractive place to do business. Allow the oil and natural gas industry to develop our nation's vast energy resources, which our investments in people and energy projects aim to do. Strengthen, don't weaken, our ability to compete against large and powerful national oil companies who are major players in the United States and the global energy market.

   How we as a country deal with our energy future is nothing less than an urgent matter of our energy and economic security. Energy is vital to our nation's economic health. As such, a reliable, efficient and affordable energy supply system is a policy imperative. Realistic solutions must balance economic, environmental and security goals. Ultimately, policies should recognize the interdependence of the United States within the global energy system, while at the same time capitalizing on our country's own extensive energy endowment. These are not insignificant challenges, and they will require leadership and collaboration.

5. **What was your effective tax rate last year?**

   Response: In 2010, Chevron's effective tax rate in the United States was 31.5%.

6. **What is your total tax benefit that you receive from the provisions targeted by recent proposals to eliminate existing tax advantages for your company?**

   Response: The annual total and/or more detailed breakout of these expenses are proprietary business information, which we need to keep confidential for competitive reasons. Percentage depletion taken on U.S. oil and natural gas production by integrated oil and natural gas companies, like Chevron, was repealed by Congress in 1975. The passive loss exception rules similarly do not apply to integrated oil and natural gas companies.

7. **The final question is directed towards Mr. Tillerson, Chairman and Chief Executive Officer, Exxon Mobil corporations**

   The proposals to eliminate oil and gas tax advantages are estimated to raise $18.54 billion over five years. Meanwhile, the cost of the Volumetric Ethanol Excise Tax Credit (VEETC) has cost over $24 billion over the last five years and will reach $30 billion if left intact through 2011.

   As a blender of ethanol – if not the largest of them – would eliminating the VEETC be a logical first step in eliminating oil and gas tax advantages, especially considering ethanol has already been granted a guaranteed market share by Congress?

   Response: Question posed to ExxonMobil.

The Honorable John Cornyn

1. **Has there been any analysis done on how these domestic energy tax hikes would impact the 9.2 million jobs that the industry supports? Can you tell the committee what it will mean to your operations?**

   Response: A Wood Mackenzie study found that a $5 billion annual tax increase would result in a loss of about 170,000 direct and indirect jobs by 2014. A recent study by Louisiana State University professor Joseph Mason, supported by the American Energy Alliance, concluded that punitive tax proposals would result in a loss of 155,000 jobs over the next decade.

   Punitive taxes would discourage new domestic energy production, both for alternatives and traditional oil and natural gas production – increasing our dependence on imported oil and decreasing our global competitiveness. Eliminating or changing long standing tax provisions that allow for the deduction of legitimate business expenses will restrict our ability to invest in the oil and natural gas that America needs. We believe there should be equitable treatment for all forms of energy and for all energy producers, large and small. Energy and tax policies should allow us to develop our nation's vast energy resources, strengthening our ability to compete against large and powerful nationalized oil companies who are major players in the United States and global energy markets.

2. **How does U.S. tax policy influence company decisions to invest in the United States to develop new energy sources?**

   Response: Chevron makes investment decisions based upon stable, predictable and competitive investment regimes. Recently, there have been a number of signals to the market that may serve to discourage investment in much-needed traditional oil and natural gas production. Punitive or discriminatory taxes on the U.S. oil and natural gas industry are contrary to the goal of providing stable and cost-effective supplies of energy for American consumers and discourage the tremendous capital investments needed to meet the nation's growing energy needs. Additional taxes discourage new domestic energy projects, thereby increasing our dependence on imported oil and products.

3. **Would you support a review of all business and individual tax provisions in the context of broad tax policy reform?**

   Response: Chevron has publicly stated that it supports broader corporate tax reform with the goal of creating a more attractive investment environment for U.S. energy investment. We have also stated that we believe that existing tax provisions for the U.S. oil and natural gas industry would need to be considered as part of the broader debate on corporate tax reform.

   We see a growing consensus that the corporate tax rate should be lowered to preserve the global competitiveness of U.S. companies. To the extent that the tax base is expanded by reducing, eliminating or deferring tax deductions and credits, that burden should be shared

broadly by all industries and categories of taxpayers. Changes should not disproportionately affect any single industry, nor should they favor one form of energy over another.

4. **What amount have your companies spent in terms of bonus bids for lease sales and royalties going to the Treasury?**

   Response: In 2010, Chevron paid over $420 million in lease, rental and royalty payments to the federal government.

5. **Is the U.S., relative to other countries, a high cost place to conduct oil and gas operations?**

   Response: U.S. oil and natural gas production costs are much higher as much of the new oil production in the United States is from higher cost deepwater resources, while new natural gas production is increasingly from difficult to recover shale resources. The International Energy Agency estimates that North American finding and development costs, or initial investment, are among the highest in the world at $12 to $26 per barrel of oil equivalent. Lifting or production operating costs are the highest in the world with a range of $8 to $16 per barrel of oil equivalent, compared to just $2 to $6 per barrel of oil equivalent in the Middle East.

   The U.S. corporate tax rate is among the highest in the world. Recently, there have been a number of signals to the market that discourage investment in much-needed traditional oil and natural gas production. Additional, punitive or discriminatory taxes on the U.S. oil and natural gas industry are contrary to the goal of providing stable and cost-effective supplies of energy for U.S. consumers. They discourage the tremendous capital investments needed to meet the nation's growing energy needs, and increase our dependence on imported oil and products.

   The dual capacity foreign tax credit, which is available to all businesses, is designed to avoid taxing the same income earned overseas twice, once in the host country jurisdiction and again in the United States. Repealing this provision would place U.S.-based companies at a competitive disadvantage with international-based companies, by subjecting them to double taxation on income earned overseas, making them less competitive internationally and costing the United States revenues and jobs that support overseas operations.

6. **How will tax increases as proposed in S. 940, impact your companies/investments in alternative energy?**

   Response: Punitive taxes would discourage new domestic energy production, both for alternatives and traditional oil and natural gas production – increasing our dependence on imported oil and decreasing our global competitiveness. Eliminating or changing long standing tax provisions that allow for the deduction of legitimate business expenses will restrict our ability to invest in the oil and natural gas that America needs. We believe there should be equitable treatment for all forms of energy and for all energy producers, large and

small. Energy and tax policies should allow us to develop our nation's vast energy resources, strengthening our ability to compete against large and powerful national oil companies who are major players in the United States and global energy markets.

We use the same standard for investing in alternatives that we use for all other aspects of our business: is there a market and can Chevron produce the product and generate a profit without government subsidies? We focus our investments on emerging technologies - those in early stages of development – nurturing them until they are ready to be commercialized. When these technologies reach a breakthrough stage, we expect spending to increase with efforts to expand their application to a commercial scale.

Statement for the Record
Senator Ron Wyden
Senate Finance Committee Hearing
"Oil and Gas Tax Incentives and Rising Energy Prices"
May 12, 2011

During this morning's hearing, one of our oil industry witnesses claimed that the major oil companies were not eligible for the oil and gas depletion allowance. While it is true that this tax credit is largely used by smaller, independent oil and gas firms, major oil companies are eligible for, and use, the credit for certain wells. As explained in the Joint Committee on Taxation memo prepared for this morning's hearing:

> "In addition to independent producers and royalty owners, certain sales of natural gas under a fixed contract in effect on February 1, 1975 and certain natural gas from geopressured brine, are eligible for percentage depletion, at rates of 22 percent and 10 percent, respectively. These exceptions apply without regard to the 1,000-barrel-per-day limitation and regardless of whether the producer is an independent producer or an integrated oil company."
>
> ("Description of Present Law and Select Proposals Relating to the Oil and Gas Industry," JCX-27-11, May 11, 2011)

COMMUNICATIONS

Congress of the United States
Washington, DC 20515

May 11, 2011

The Honorable Lisa Jackson
Administrator, U.S. Environmental Protection Agency
Ariel Rios Building, Mail Code: 1101A
1200 Pennsylvania Avenue, NW
Washington, DC 20460

Dear Administrator Jackson:

Gas prices have skyrocketed these past few months. According to the Energy Information Administration (EIA), the price per gallon of gasoline has jumped a dollar in the past two months alone. Many have predicted that gas prices could spike even higher by the end of next year. These prices demonstrate the vulnerability of our energy supply to the many factors affecting the price of gasoline in the United States.

EIA stated in a 2002 report that one factor affecting gas price volatility is the increased use of different types of fuels in different localities. The proliferation of these specialty or "boutique" fuels increases the chance that localities using them will experience faster inventory depletion when nationwide gas supplies are low. This makes these localities especially vulnerable to a surge in gas prices. From this, the report concludes that addressing the boutique fuel problem would most likely diminish the frequency and magnitude of price surges.

In the Energy Policy Act (EPACT) of 2005, we took the first important step to address this problem by capping the number of fuels allowed and giving EPA authority to waive fuel specifications in the event of a natural disaster. In 2005, when Hurricane Katrina hit, 20 percent of this nation's refinery capacity was shut down. The waiver authority proved integral to the response to this massive supply disruption.

Temporary measures such as these are important and aim to reduce the brunt of price spikes during a disruption, but they will not bring us closer to a permanently streamlined and more reliable fuel delivery system. That's why Congress directed EPA and the Department of Energy (DOE) in Section 1509 of EPACT of 2005 to jointly undertake a Fuel Harmonization Study in order to ascertain the effects varying fuel standards might have on issues like price, and to assess the feasibility of developing national or regional fuel standards. Indeed, EPA devoted a large portion of its Section 1541(c) Boutique Fuels Report to Congress explaining how it would approach a more "comprehensive assessment" of the impacts of boutique fuels in the Fuel Harmonization Study. This report was due to Congress by June of 2008, and Congress is still waiting.

Unfortunately, EPA and DOE never did the report, and has provided no explanation as to why it disregarded its congressional directive. Comprehensive empirical evidence assessing the give and take between reliability and price stabilization is much needed. Congress seeks to draw upon

the expertise in the different agencies by commissioning studies in cases such as these, and it is incumbent upon agencies to respond in a timely way and to follow congressional intent.

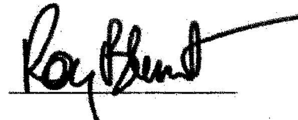
Therefore, we respectfully ask that you respond to this letter with an answer to the following questions:

- Will EPA and DOE ever conduct the Fuel Harmonization Study that was required by Section 1509 of EPACT of 2005? If so, when can Congress expect to see the final report?
- Since the demand for oil continues to increase, and the price of gasoline continues to rise, as the country recovers from the economic recession, does EPA not see the utility in conducting a study to aid in the simplification of our fuel delivery system?

The global supply and demand factors affecting the price of oil paired with our heavy reliance on foreign sources of oil leaves us susceptible to price volatility when that oil is refined into gasoline and sold on the open market. Increasing the domestic exploration for our American energy is one important way to decrease our dependence on foreign oil and make us less vulnerable to price spikes and volatility. Another way to achieve this goal is to simplify our nation's increasingly complex gasoline supply to resolve the distribution issues that would otherwise lead to potential gasoline price spikes. We expect EPA and DOE to follow the congressional intent that was outlined in EPACT of 2005 and conduct the Fuel Harmonization Study as soon as possible, to better inform us on how the reduction of unnecessary domestic energy constraints caused by the proliferation of boutique fuel use will affect the price of gasoline.

Thank you for your consideration. We look forward to your prompt response.

Sincerely,



cc: The Honorable Steven Chu, U.S Department of Energy

Oil and Gas Tax Incentives and Rising Energy Prices

Hearing on May 12, 2011

Max Baucus, Chairman

Orrin Hatch, Ranking Member

Members of the Senate Finance Committee

Submitted By: Coleen M. Logan

P.O. Box 669

Helotes, TX 78023-0669

In light of recent reports of record profits in the first quarter of 2011 for the Big Oil Companies ($11 billion for Exxon alone), I respectfully request an end to the approximately $4 billion in tax breaks for the oil and gas industry.

I understand factors currently influencing the price of gas include the weak U.S. dollar, global demand, and political instability in the Middle East. My request to end the tax breaks does not stem from the price of gas, but rather the **inequity** and **invalidity** of some of these subsidies at a time when our country faces huge financial deficits. It is grievous and shameful that these companies are raking in huge profits, paying little in taxes, and reaping the benefits of tax breaks that are no longer valid, especially at a time when the country suffers. Some of these subsidies were created as far back as the early 1900's for reasons that no longer exist. With record profits, I question the need for these obsolete subsidies.

Every industry and profession must revisit and reevaluate its operating procedures to maintain validity and best practices. Why have these subsidies not come under the same reevaluation? Do the oil companies really still need a subsidy that was established to help fuel the production of oil for the Industrial Revolution? Even a single family budget comes under scrutiny and revamping as priorities change. Helping the oil and gas industry is no longer a need or priority, **as evidenced by their bottom lines** -- solving our national debt IS a priority.

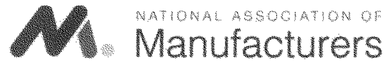
Further, I resent the attempt by the Big Oil Companies to hold on to these subsidies. In one report on CNN (Your $$$$ with Ali Velshi, 4/30/11), Exxon presented a defense by listing taxes paid last year, which included SALES TAX. Their deceitful defense was that they had paid several billions in sales tax, a tax that as any small businessman will corroborate, is collected for and distributed to government entities but is not a tax that comes out of the profit. According to their own numbers presented in the report, Exxon easily paid all of their tax liabilities for the year with first quarter income, and had over several billion in profits to spare. Can you defend this industry's need for subsidies?

If Congress allows this inequity to continue, you are NOT being good stewards of our national tax revenues, and you are flagrantly contributing to the continued downward spiral of our national financial situation.

I am not a Democrat, and have not to date voted for a Democratic Senator. However, I am asking that you please support President Obama's call to end tax breaks for this industry.

cc: Senator Kay Bailey Hutchison, TX

Senator John Cornyn, TX



Leading Innovation. Creating Opportunity. Pursuing Progress.

STATEMENT

National Association of Manufacturers

before the Senate Finance Committee

on Oil and Gas Tax Incentives and Rising Energy Prices

May 12, 2011

COMMENTS OF THE NATIONAL ASSOCIATION OF MANUFACTURERS
BEFORE THE

SENATE FINANCE COMMITTEE

MAY 12, 2011

Mr. Chairman and Members of the Committee,

The National Association of Manufacturers (NAM) is pleased to have the opportunity to submit this statement for the record of the May 12, 2011, Senate Finance Committee hearing on Oil and Gas Tax Incentives and Rising Energy Prices. The NAM is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states.

Overview

The U.S. manufacturing sector uses nearly one-third of the nation's energy both as a fuel and as a feedstock and NAM strongly supports Congressional efforts to enhance America's energy independence and security. Without reliable and affordable energy sources, our manufacturing sector will not thrive. Manufacturers believe that the United States needs a comprehensive strategy that encourages the energy industry's efforts to develop the resources necessary to ensure an adequate energy supply. Affordable and reliable sources of energy are critical to ensuring a healthy manufacturing sector in this country and the competitiveness of U.S. manufacturers in the global market place.

NAM has long advocated for a diverse energy portfolio and we understand the value of getting the most out of our energy sources through improved conservation and energy efficiency. Many of our member companies are involved in significant research on technology that would produce alternative energy and increase access to domestic sources all while better protecting our environment and improving distribution. Nevertheless, it is clear that oil and gas will continue to play a significant role in our energy mix in the foreseeable future. Developing energy resources both domestically and overseas makes sense as we seek greater energy security in our effort to create new jobs and grow our economy. Consequently, we are extremely concerned with the proposals under consideration in Congress that would increase taxes for energy companies and discourage needed investment in energy infrastructure and supply. Targeting the

oil and gas industry with punitive, discriminatory taxes is not the way to secure our nation's energy future.

Punitive Tax Increases

In particular, the NAM strongly opposes a proposal that would increase taxes on oil and gas companies by making them ineligible for the Sec. 199 deduction for domestic manufacturing activity. Sec. 199—enacted in 2004—is designed to reduce the tax burden on domestic manufacturers to help spur investment in the United States and create U.S. jobs. The combined federal and local U.S. statutory corporate tax rate, at more than 39 percent, is one of the highest among developed countries and more than 10 percentage points higher than the average corporate tax rate for other countries in the Organization for Economic Cooperation and Development. Moreover, U.S.-based oil and gas companies have one of the highest effective tax rates of any industry, both on a global basis and when looking at only at domestic income.

The Sec. 199 provision, which reduces the federal tax rate on income from domestic manufacturing activities, helps mitigate this tax burden for all domestic manufacturers, including energy companies. By reducing the tax burden on income from U.S. activities, the Sec. 199 deduction encourages more oil and natural gas production in this country, and helps attract needed capital to spur new petroleum refining capacity. As a result, high-paying U.S. jobs are preserved, and U.S. reliance on imported oil and related products is reduced.

In contrast, increasing taxes on the income from U.S. oil and natural gas production, refining and processing by eliminating this tax deduction will discourage new oil and gas investments in the United States by making domestic energy investments less competitive economically with foreign opportunities.

Manufacturers also oppose a proposal that would potentially subject overseas investments by U.S. energy companies to double taxation. The ability of U.S. energy companies to compete for global natural resources is critical to U.S. energy security. Their overseas exploration and production operations help provide a stable energy supply, which ensures a competitive and robust manufacturing sector in the United States.

U.S. energy companies with overseas exploration and production operations, so-called "dual-capacity" taxpayers, are subject to both U.S. taxes and foreign taxes while their non-U.S. competitors generally only pay taxes where income is earned. Current rules for "dual-capacity" taxpayers, already stricter than for other taxpayers, are structured to reduce double taxation of

income under the U.S. worldwide tax system and limit credits for foreign taxes to payments that are truly in the nature of income taxes. Existing rules specifically deny credits for payments such as royalties paid to access a natural resource.

The proposal under discussion however, would deny foreign tax credits even for income taxes. It would unfairly and retroactively overturn well-established rules, subjecting American energy companies to double taxation on new and existing investments. As a result, the value of existing overseas investments would decline and, in some cases, become unprofitable. Faced with higher costs, U.S. companies would have difficulty competing with foreign competitors for new investments, threatening our nation's long-term energy security.

Conclusion

Increased taxes for energy companies, including the proposals described above and other energy tax increases, will divert funds away from much-needed investments and jobs and also increase the costs of fuel to American energy consumers and manufacturers. The debate over energy policy should not be about imposing new taxes or new costs on the U.S. energy industry. Rather, the debate should focus on enhancing America's energy security through increased production of all types of energy, improved conservation and energy efficiency, more research on technology and alternative energy, increased access to domestic sources with continued environmental protections, and improved distribution. These goals are good for manufacturers, their workers and the overall U.S. economy. Thank you for considering our comments. We look forward to working with you on these important issues.

May 16, 2011

U.S. Senate Committee on Finance
Attn. Editorial and Document Section
Rm. SD-219
Dirksen Senate Office Bldg.
Washington, DC 20510-6200b

The Texas Society of Certified Public Accountants respectfully submits the enclosed analysis as a written statement into the hearing records on:

"Oil and Gas Tax Incentives and Rising Energy Prices"
Thursday, May 12, 2011, 9:00 a.m.

We support the Senate Finance Committee's dialogue to narrow the federal deficit and respond to the nation's growing concern over high fuel prices. While these issues are vital to the U.S. economy, any increase in taxes on oil and gas exploration and development should be weighed against its potential to devastate independent producers that directly and indirectly support tens of thousands of domestic jobs. TSCPA's Federal Tax Policy Committee recently prepared the analysis of the harmful effects such proposed legislation would have on the oil and gas and related industries, particularly small businesses.

The analysis focuses on four provisions: deductions for intangible drilling costs (IDCs), deductions for percentage depletion, the manufacturing deduction, and the exception to the passive loss limitation rules for working interests in oil and gas properties. We believe that these proposed changes to the tax code would result in a significant shift in the industry's capital investment, contributing to slower economic growth and net job loss in Texas and across the United States, particularly among small businesses.

In many cases there is a misconception that "Big Oil" benefits from significant subsidies. On the contrary, our analysis points out that:

- Percentage depletion was repealed for Big Oil in 1975;
- Big Oil is already limited to a portion of IDC deductibility;
- Section 199 manufacturing deduction for Big Oil (as well as small producers) was reduced to six percent compared to other domestic manufacturers that receive a nine percent deduction; and
- The passive loss exception for working interests only affects individuals.

The Texas Society of CPAs urges members of the Senate Finance Committee to carefully consider how the proposed changes would affect small businesses and individuals employed in the oil and gas and related industries across the U.S.

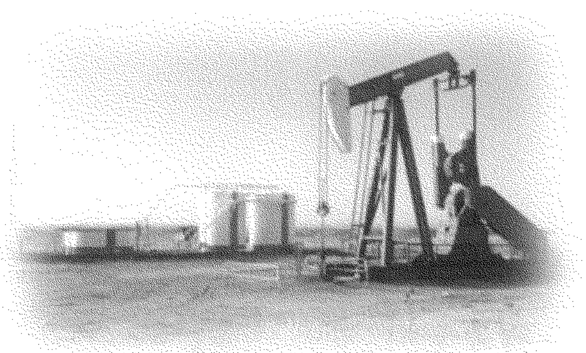
Sincerely,

C. Jeff Gregg, CPA
Chairman

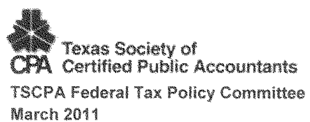
John M. Sharbaugh
Executive Director/CEO

/pmw
Enc.
cc: The Honorable John Cornyn, Texas Member, U.S. Senate Finance Committee

14651 Dallas Parkway, Suite 700 • Dallas, Texas 75254-7408 • 972/687-8500 • 800/428-0272 • Fax 972/687-8646



Analysis of Legislative Proposals to Repeal Certain Tax Treatments of Domestic Oil and Gas Exploration and Development



TSCPA Federal Tax Policy Committee

March 2011

Acknowledgments

Principal responsibility for preparing this analysis was exercised by the following members of the TSCPA Federal Tax Policy Committee's Oil & Gas Task Force:

Key Contributors

E. Leroy Bolt, CPA, ABV
Condley and Company, L.L.P; Abilene, Texas
Chair, Oil and Gas Task Force

R. Byron Ratliff, CPA
PricewaterhouseCoopers, L.L.P;
Houston, Texas

Joseph D. Brophy, CPA, ABV, CVA, CM&AA
Joseph D. Brophy, CPA, P.C.; Dallas, Texas

Larry D. Edgerton, CPA
Weaver, L.L.P.; Midland, Texas

Technical Writers

Thomas P. Ochsenschlager, CPA, J.D.
Great Falls, Virginia

William R. Stromsem, CPA, J.D.
The George Washington University
School of Business
Washington, D.C.

Feedback

Please send comments or suggestions about this document to the TSCPA Federal Tax Policy Committee at pwyatt@tscpa.net.

Disclaimers

This analysis reflects the collective views of the Oil & Gas Task Force, and does not purport to represent the views of any individual member or their business or organization affiliations. Data contained in this analysis is for informational purposes only and is intended to assist and expedite professional assessment. To ensure compliance with U.S. Treasury Regulations governing tax practice, we inform you that any U.S. federal tax advice contained in this document is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding any penalties under U.S. federal tax law, or (ii) promoting, marketing or recommending to another party, any transaction or matter addressed herein.

The Texas Society of Certified Public Accountants (TSCPA) is a nonprofit, voluntary professional organization representing more than 29,000 CPAs. One of the expressed goals of the TSCPA is to speak on behalf of its members when such action is in the best interest of its members and serves the cause of CPAs in Texas, as well as the public interest. The TSCPA has established a Federal Tax Policy Committee (FTP) to represent those interests on relevant tax matters. The FTP has been authorized by the TSCPA Board of Directors to submit comments on matters of interest to committee membership. The views expressed herein have not been approved by the TSCPA Board of Directors or Executive Board, and therefore, should not be construed as representing the view or policies of the TSCPA.

Analysis of Legislative Proposals to Repeal Certain Tax Treatments of Domestic Oil and Gas Exploration and Development

Table of Contents

Introduction 4
Financing Oil and Gas Drilling 4
Importance of Oil and Gas Drilling to the Economy 5
Tax Treatment of Oil and Gas Drilling 6
  Intangible Drilling Costs 6
  Percentage Depletion 6
  The Manufacturer's Deduction 7
  Passive Loss Exception for Working Interests in Oil and Gas Properties 7
Conclusion 8

Introduction

The United States is currently experiencing a significant budget deficit with projected expenditures exceeding income of nearly $1.4 trillion dollars for the fiscal year ending September 30, 2011. Both Congress and the Administration are rightfully concerned with the magnitude of this deficit and both have proposed spending cuts and certain decreases in so-called "tax benefits" in an effort to reduce the size of the shortfall. Among the measures suggested by the Obama Administration are four that would have a direct impact on the oil and gas industry. These include repealing the expensing of intangible drilling costs, the percentage depletion allowance, the domestic manufacturing deduction, and the exemption to the passive loss limitation for working interests in oil and gas. The Joint Committee on Taxation estimates that, taken together, over the 10-year measuring period, repealing these provisions would generate an additional $35.6 billion[1] in tax revenue.

While reducing the deficit is a desirable goal, any effort to do so by raising taxes on oil and gas exploration and development should be weighed against its potential to exacerbate our current under-employment issue and our need for a secure source of energy. The following discussion will describe the negative effects upon the domestic oil and gas industry if efforts to repeal these provisions were to be successful. This paper will not attempt to address the longer term issues related to alternative energy development, the preservation of resources, and the environment.

This paper focuses on four provisions that are currently the subject of proposals calling for repeal: deductions for intangible drilling costs, percentage depletion, the manufacturing deduction, and the exception to the passive loss limitation rules for working interests in oil and gas properties.

Financing Oil and Gas Drilling

The U.S. is a mature oil and gas producer; finding scarce new oil and gas sources is more difficult, less certain and can be more costly than in other parts of the world. Forty percent of exploratory drilling in the U.S. results in dry holes.[2] Most new onshore wells in the U.S. are drilled by smaller, independent producers. Credit constraints of financial institutions generally preclude their participation in speculative oil and gas projects, so private investors must often provide the funds. The tax policies permitting percentage depletion and the immediate deduction for intangible drilling costs have been in the Internal Revenue code for more than 50 years, recognizing the inherent risks of the industry, and resulting difficulty in raising funds to finance exploration and production activities. Provisions similar to these oil and gas provisions apply to the mining industry and for all other land-producing minerals.[3]

---

[1] Joint Committee on Taxation, "Estimated Budget Effects of the Revenue Provisions Contained in The President's Fiscal Year 2011 Budget Proposal [1]," JCX-7-10R (March 15, 2010), 9, http://www.jct.gov/publications/ (accessed March 10, 2011).
[2] American Petroleum Institute, "Quarterly Well Completion Report" (2010), Fourth Quarter, vol. 26, no. 4, Finance, Accounting and Statistics Department.
[3] However, note that the Obama Administration's 2012 budget also contains similar proposals to repeal certain coal industry tax provisions like the deduction for mine exploration and production expenditures, percentage depletion and manufacturer's deduction qualification.

Importance of Oil and Gas Drilling to the Economy

While all businesses play an important part in the U.S. economy, the oil and gas industry and the independent oil and gas producers, in particular, make a uniquely significant contribution. Energy exploration affects the availability of oil and gas which impacts our trade deficit and the security that derives from having a domestic source of oil and gas. It influences both business and household purchasing power. Any uptick in price affects how businesses, both energy and non-energy, make investment decisions for goods and services. Families' utility and fuel expenses can offset the purchase of other basic necessities. The travel and tourist industry is inherently tied to oil prices. Land values of potential oil and gas reserves along with the security interest of their financial lenders are influenced by the price of these products. An increase or decrease in the cost of oil and gas has a direct effect on inflation with energy costs included in raw materials, such as plastics, production costs and transportation costs. In addition to this indirect effect on the economic well being of the country, independent oil and gas producers directly and indirectly provide a significant percentage of jobs in many communities.

In Texas, the oil and gas industry provides more than 1.7 million jobs and accounts for nearly 25 percent of the state's economy.[4] Nationwide, the industry provides jobs for 9.2 million workers[5], represents 7.5 percent of the overall U.S. economy, has invested more than $2 trillion in domestic capital projects over the last 10 years[6] and paid nearly $100 billion in federal income taxes in 2008 alone (the latest year figures are available).[7] Moreover, it is one of the few industries that has added significant numbers of jobs in the current economy. In 2009, just the development of the Marcellus Shale gas reserves added 57,000 new jobs in Pennsylvania and West Virginia.[8] The *San Antonio Business Journal* in its February 24, 2011 issue cited a study by the Center for Community and Business Research at the University of Texas at San Antonio's Institute for Economic Development: "The Eagle Ford Shale is expected to generate more than $21.5 billion in total annual economic output and support roughly 68,000 full-time jobs in South Texas by 2020."

The oil and gas industry provides more than 1.7 million jobs and accounts for nearly 25 percent of the Texas economy.

If offshore wells are included, approximately 40 percent of oil consumed in the U.S. comes from domestic wells.[9] That represents an important safeguard against being overly dependent on foreign energy sources subject to the political and economic circumstances of other countries. By supporting our independent oil and gas producers, jobs are not being exported overseas and the production created is secure from international conflicts and unrest. Some foreign countries have enormous proven reserves

[4] PricewaterhouseCoopers LLP, "The Economic Impacts of the Oil and Natural Gas Industry on the U.S. Economy: Employment, Labor Income and Value Added" (September 8, 2009), 2-3, Internet.
[5] Ibid, 9.
[6] "Capital Spending Outlook 2001-2010" (Spring), *Oil and Gas Journal*.
[7] U.S. Energy Information Administration, "Form EIA-28, the Financial Reporting System" (2008).
[8] Timothy J. Considine, Ph.D., "The Economic Impacts of the Marcellus Shale: Implications for New York, Pennsylvania, and West Virginia" (July 14, 2010), 26, Natural Resource Economics, Inc., Internet.
[9] Arthur B. Laffer, "Obama Should Forget About Energy Independence," *The Wall Street Journal* (December 18, 2008).

that prevent the need to incur exploration costs which, in turn, results in a much lower cost per barrel than with domestic reserves. Maintaining tax policies that encourage domestic exploration and development will help protect capital and jobs from shifting to foreign producers. The U.S. has been a leader in developing high-technology drilling techniques, along with energy production, income and jobs.

Maintaining tax policies that encourage domestic exploration and development will help protect capital and jobs from shifting to foreign producers.

Tax Treatment of Oil and Gas Drilling

Intangible Drilling Costs

The advance preparation and the actual drilling of a well are capital intensive and, even if the well is successful, it can take several years of production before the net income is sufficient to cover these costs. Without rapid cost recovery of these drilling expenditures which possess no salvage value, investors would be looking at a high risk venture with, at best, a deferred return of their investment. This financially bleak prospect is somewhat lessened by a longstanding provision in the tax law that permits an elective current deduction for the investors for these preparation and drilling expenses—technically known as intangible drilling costs ("IDCs")—in the year in which these costs are incurred. The costs would be fully deductible even without this provision in the Internal Revenue Code. If the well turns out to be dry, as is frequently the case, these same costs are immediately deductible under general tax law that applies to all business losses. If the well is successful, the tax law clearly permits these business costs to be deducted over the useful life of the well if no election to deduct IDCs was made. Permitting the deduction "up front" has no effect on the long- term revenues of the U.S. government, but it makes a difference to the investors. Depending on their marginal tax rate, they immediately have less at risk, making the investment more tolerable.

There have been proposals in Congress to repeal the election to deduct IDCs. If those proposals were to pass, it could reduce the ability of independent oil and gas producers to attract the capital investment needed to explore and produce new sources of energy. The oil and gas industry is not the only one that benefits from similar tax provisions allowing rapid recovery of high risk expenditures. For example, mine exploration and development expenditures are generally deductible and research and experimentation expenditures are deductible.

Percentage Depletion

If the well is successfully productive, the tax law since 1926 has permitted investors to claim a "percentage depletion" deduction. Percentage depletion is allowed for all natural resource production. This provision was repealed for oil and gas production for all but independent producers and royalty owners in 1975, and only then, with numerous limitations (e.g., limited to a set amount of production per year and 65 percent of taxable income). These limitations ensure that only the smallest of producers and royalty owners receive the full benefit of the deduction. Percentage depletion reduces the investor's cost basis in their investment. Although percentage depletion can exceed the basis of a well in some cases, much of this deduction would be received through cost depletion over a longer period of time. But, like

the "up front" deduction for IDC discussed above, timing is important to the investors. The proposals would repeal percentage depletion for all oil and gas wells while leaving percentage depletion intact for almost all other extractive industry production.

The Manufacturer's Deduction

More recently, the "manufacturer's deduction" was enacted to reduce the rate of tax on domestic manufacturing. Congress enacted the Section 199 manufacturing deduction in the American Jobs Creation Act of 2004 to assist U.S. companies competing in the world economy, and to stimulate investment and jobs formation. The U.S. has one of the highest corporate marginal rates of tax among developed countries (second only to Japan which is about to pass a rate reduction). Currently, most domestic manufacturers are permitted a deduction that is generally equal to nine percent of their net manufacturing income. That deduction has been reduced to six percent for the production, refining, processing, transportation or distribution of oil and gas and its primary products. The legislative proposals would eliminate it altogether for the oil and gas industry.

Beyond keeping jobs in America, if the manufacturing deduction were to be repealed for the oil and gas industry, it would further tilt an unlevel playing field when the domestic oil and gas industry competes for investment dollars with other, less risky, manufacturers.

What could we expect if the IDC deduction and the manufacturer's deduction were to be selectively repealed for the oil and gas industry? Wood MacKenzie completed a study in August 2010, for the American Petroleum Institute.[10] Based on a sample of 230 wells[11], it concluded that without these incentives, the number of prospective wells economically viable for investors would fall from 88 under current law to 55. That represents an increase in the economic failure rate from 24 percent to 38 percent. The study projects this would result in a loss of production of as much as three billion cubic feet per day of natural gas, 60,000 barrels per day of oil, and a reduction in investment of $15 billion in 2011 alone.[12] And that translates into 58,000 jobs at risk in 2011, rising to 165,000 by 2020.[13] The Wood Mackenzie report expects the U.S. would need higher oil and gas prices to incite drilling or almost all growth potential in the U.S. would be eliminated.[14]

Passive Loss Exception for Working Interests in Oil and Gas Properties

By way of background, the passive loss rules generally limit deductions from trade or business activities in which the taxpayer does not materially participate to the extent of income from other passive trade or business activities. Any unused losses are carried forward indefinitely or until the investor makes a tax disposition of their investment.

[10] Study by Wood MacKenzie analyzed 230 fields and plays (onshore drilling targets) with future development potential for purposes of estimating an overall production and investment impact, "Evaluation of Proposed Tax Changes on the US Oil & Gas Industry" (August 2010), Internet.
[11] Ibid, 7.
[12] Ibid, 10.
[13] Bill Bush, "Poll: By two-to-one Americans oppose new oil, natural gas industry taxes – most cite job loss fears." *API Energy Newsroom* (September 15, 2010), survey by Harris Interactive, Internet.
[14] Wood Mackenzie, 13.

For the last 25 years since the inception of these rules, the tax law has provided an exception to the passive loss rules where an investor directly owns (or owns through a partnership or other entity that does not limit his or her liability) a working interest in an oil or gas property. As stated above, typically drilling activities produce losses in the early years, therefore, without this exception, the current benefits of the deduction for intangible drilling costs and percentage depletion would be deferred until the well became profitable (or until the investors sold their interest). Investors look to the current tax benefits of these deductions as a mitigating factor to the inherent risk of oil and gas exploration. Moreover, there are safeguards against overuse of this tax provision: in order to take advantage of the exception, the taxpayer must be willing to structure the investment to assume the risk of financial ruin from accidents or environmental damage as a result of drilling.

Again, it is important to note this is a temporary benefit in the sense that, over the life of the well, the tax revenue will be the same. It's the timing of this deduction that is crucial to attracting the necessary capital.

Conclusion

Long-standing tax policies and tax accounting treatments are appropriate and necessary to attract investors to energy exploration and development projects. Oil and gas exploration and production is important to the economies of Texas and other energy producing areas of the U. S. Without these tax treatments, capital may not be available for many oil and gas projects, resulting in loss of jobs; a slower economic recovery and more dependence on less reliable foreign energy sources.

Changes to the tax benefits that have helped build a strong energy industry affect Texas and American businesses and households. Congress should carefully consider the far-reaching effects of any proposed changes.