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Mr. Chairman, members of the Committee, it is my pleasure to appear before you today to discuss the Strategic Petroleum Reserve (SPR) and its important role in providing energy security to the United States.

ENERGY SECURITY

Our Nation's energy security is directly intertwined with our national security. In fact, we are in a time of great risk when it comes to both realities. Global energy consumption will increase by roughly 50 percent by 2030, with 70 percent of that growth coming from the world's emerging economies. While oil's share of total energy use is projected to decline, it is projected to remain the single largest source of energy through 2030, with oil increasing in absolute terms. Oil resources are often located in places geographically hard to reach, difficult to develop and politically unstable, or unfriendly to new foreign investment, superior technology, and modern business practices of international energy companies.

Record high oil prices reflect growing global demand, limited spare oil production capacity due to insufficient investment in producing new supply, lack of investment in exploration and rising development costs. In 2006, the United States imported over 12 million barrels of petroleum a day, accounting for roughly 60% of our daily consumption.

Although we must answer today's question on reserve capacity, we must also confront the question of tomorrow, which is how to reduce America's dependence on fossil fuels to begin

with? We must, as a global leader, fundamentally transform the way the world produces and consumes energy. We must expand and diversify our energy supply and our suppliers, increase our energy efficiency, modernize and expand our infrastructure and improve our environmental stewardship.

We must confront the reasons we are dependent on foreign oil, and how we can mitigate these circumstances, including increased domestic exploration and production. Our domestic exploration has nearly bottomed out. Despite all the concern about reliance on foreign oil this Nation continues to forego available self help: the tremendous resource available in ANWR and the vast majority of the Outer Continental Shelf. The Department is continually working to develop alternative energy sources and improve our existing energy infrastructure and eliminate the road blocks to that progress.

Only by confronting our energy security in its entire context, can we properly make decisions on our national reserves and their critical importance to our Nation in time of natural or unnatural emergencies. In looking at the two emergency drawdowns in the SPR's history, it is clear this vital tool was essential during both events, whether as the result of a global conflict like Operation Desert Storm, or a natural disaster, such as Hurricanes Katrina and Rita where approximately 25 percent of our Nation's refining capacity was impacted. Our reserves were critical in these time periods and were immediately put into action.

The conversation should not focus on *whether* the Strategic Petroleum Reserve serves a significant role in our energy security, because it unquestionably does as our Nation's one and only insurance policy against global supply disruption. The conversation should also not focus on whether the Reserve serves its purpose as America's fulfillment of its international treaty commitments, as agreed to in the Agreement for an International Energy Program, because we

do. The conversation should instead focus on a shared philosophy to increase the capacity of the Reserve, and answer the President's call in his 2007 State of the Union address to double it. This conversation is imperative and needs to be addressed so that the United States has the appropriate and necessary layer of protection it needs to ensure that adequate energy supplies are available to the American people in the case of a severe supply disruption. Our energy and national security concerns must be paramount.

BACKGROUND

In response to the 1973 Arab oil embargo, Congress enacted the Energy Policy and Conservation Act (Public Law 94-163) to establish the SPR. It was authorized in recognition of the long-term dependence of the United States on imported crude oil and petroleum products and the protection that a national petroleum stockpile would provide in the event of future severe supply interruptions.

As of today, the SPR has an inventory of 698.6 million barrels of its current capacity of 727 million barrels. In case of a severe supply disruption, that accounts for roughly 58 days of U.S. petroleum imports based on Energy Information Administration (EIA) historical import information. By law, the SPR may be used if the President determines that a severe oil supply interruption has occurred that threatens the economic security of the United States or in fulfillment of international treaty obligations.

CURRENT STATUS

By the end of March 2008, we expect the SPR inventory to reach 700.7 million barrels, the highest volume to date. That was the level reached just before Hurricane Katrina devastated the Gulf Coast area in 2005, triggering a complete shutdown of production and extensive damage to the refining and distribution facilities in the region. As a result, President Bush issued a

finding of a severe energy supply emergency. Short-term loans (or time exchanges) totaling 9.8 million barrels were also executed. The International Energy Agency (IEA), then authorized a 60 million barrel drawdown to counter the effects on the global market, of which the U.S. offered to obligate approximately 30 million barrels to the market. This resulted in the competitive sale of 11 million barrels. The loaned oil and accompanying premium barrels were replaced by May 2007.

According to an IEA Report published in September 2007, total oil stocks in the U.S. currently, including the SPR, roughly equal to 120 days of net oil imports, or about 80 days of total consumption. There are no compulsory stock requirements for oil companies in the United States. The number of days of net import protection that the SPR inventory provides has significantly declined since the end of 1985. Import dependency has steadily risen, from 30% of demand in 1985 to approximately 60% in 2004. The SPR's net import coverage has fallen from a high of 118 days at the end of 1985 to a range of approximately 55 days in recent years. Increases in the SPR volume since 2001 have interrupted the downward trend.

IEA COMPLIANCE

The United States is a founding member of the International Energy Agency (IEA). The IEA was formed with the understanding that the energy security of the oil consuming and producing nations is interdependent. Member countries must maintain the equivalent of 90 days of net oil imports as emergency reserves and take cooperative action in the event of a severe oil supply interruption. The IEA currently has 27 member countries and we are working to encourage other countries such as China and India to establish strategic reserves and manage them in accordance with IEA principles. Expanding IEA membership and promoting the establishment and implementation of IEA best practices support the ongoing mission of the SPR.

The United States' obligation as a signatory to the International Energy Program requires that we: (1) hold emergency stocks equivalent to at least 90 days of net oil imports (which can be met through reliance on government owned, commercial or both), and (2) release stocks and share available oil in the event of a major supply disruption. The Agreement on an International Energy Program (the Charter of the IEA) carries the commitment and status of a treaty. The U.S. SPR alone represents roughly 46 percent of total IEA strategic reserves.

While committed to the principles of the free market, we believe that it is the responsibility of the U.S. Government to ensure energy supply for the Nation and fulfill its commitment to the IEA. The most effective deployment of a strategic petroleum reserve is guaranteed by maintaining Government-owned and operated stocks. It is the policy of the Administration that the SPR be used only for severe supply emergencies and not for price or market manipulation.

Oil initially purchased for the SPR was chosen to represent the crudes being processed by U.S. refineries. Seven categories of crude were used to define the crude quality for acquisition. However, in order to achieve the required site drawdown rates, it was necessary to commingle similar sweet crude types in storage. Today, the SPR maintains only two oil segregations in storage at its sites. One is sweet crude, which has a sulfur content of no greater than 0.5 percent. The second is sour crude with a higher sulfur content of approximately 1.4 percent. Both crude types are classified as light oil having an American Petroleum Institute (API) gravity that ranges from 30 to 37 degrees.

Light crudes were selected because they offer several significant advantages in the event of a crude import disruption. First, light sweet crudes can be refined or processed by all refineries, from the simplest to the most complex. Light crudes are the easiest crudes to refine,

requiring only the basic refinery processing units. They do not require all the desulphurization equipment and vacuum distillation, cat cracking, or coking units to handle the heavy bottoms. Second, most refiners can use light sweet crudes to increase or maximize their refinery output of light distillates. Sweet crudes can be used by many refineries to increase refinery utilizations beyond normal levels. This is especially important when refined product exports have been disrupted – light crudes will produce the maximum volumes of gasoline and naphtha. A barrel of light crude will yield more gasoline and naphtha in refining than a barrel of medium or heavy crude would. This is important to the U.S. whose transportation system and economy is so highly dependent on gasoline.

In 2005, the SPR conducted a comprehensive Crude Compatibility Study of the current SPR crude oil streams. In general, the crudes currently stored in the SPR are compatible and desirable for the majority of the U.S. refineries and are well suited to mitigate most supply disruptions. There are, however, eleven refineries of the 150 in the U.S. which have been specifically configured for processing heavy crude largely from Latin America that would be impacted in the event of a disruption of foreign crude supplies. However, they would still be able to process a limited quantity of SPR crude and maintain their full production of gasoline.

To address the potential compatibility issues of the eleven heavy crude refiners and provide full protection for the Nation for all disruption scenarios, DOE has stated in the SPR Crude Compatibility Study, it will consider the storage of some volumes of lower gravity crude in the planned expansion of the SPR to 1.0 billion barrels.

SPR FILL POLICIES AND GOALS

The SPR achieved its congressionally mandated goal of 90 days of import protection in 1983. In 1985, the SPR's import protection level was 118 days. In the early 1990s, Congress

discontinued funding for SPR oil acquisition and SPR fill activities were suspended in 1994. As a result of increasing U.S. petroleum consumption and increasing import dependence, the SPR's import protection level currently stands at roughly 58 days.

In 1999, the Clinton Administration took steps to reverse this erosion in the Nation's import protection by taking Federal royalty oil in-kind from offshore production leases and transferring it to the Department of Energy to fill the SPR. After the attack on September 11, 2001, the President directed the SPR to be filled to its then full capacity of 700 million barrels using Federal royalty oil in the interest of national security. This took four years and was achieved in August 2005.

In the Energy Policy Act of 2005 (EPACT 2005), Congress directed the Secretary of Energy to acquire petroleum in sufficient quantities to fill the SPR to the 1,000,000,000-barrel capacity "as expeditiously as practicable", without incurring excessive costs or appreciably affecting the price of petroleum products to consumers. It also directs the Secretary of Energy to promulgate procedures for the acquisition of petroleum for the Reserve. In addition, the law requires that the procedures include criteria for reviewing requests for the deferral of scheduled deliveries. The Administration has endorsed this SPR fill policy, finalized the necessary procedures, and resumed SPR fill activities in 2007.

In 2007, President Bush called on Congress in his State of the Union address, "…to further protect America against severe disruptions to our oil supply, I ask Congress to double the current capacity of the Strategic Petroleum Reserve." This increase to 1.5 billion barrels will provide vital petroleum stocks to protect America against potential disruptions to our oil supplies and disastrous impacts to our economy.

Under the SPR's EPACT 2005 oil acquisition procedures, DOE assesses current market conditions and the impact of acquiring additional oil for the Reserve - a market analysis which includes a review of current and future prices in official outlooks published by the EIA and IEA as well as other industry assessments and expert studies.

Royalty-in-kind (RIK) exchanges are conducted on a value basis and the quantity of oil received by the Government is independent of contracted crude oil prices. Separate market analyses conducted to address the restart of the SPR oil fill program using RIK exchange in the last half of 2007 and its continuation during the first half of 2008 concluded that the quantities involved would not exacerbate market conditions and the potential benefits derived from incrementally increasing the size of the SPR outweigh any potential risk to the market.

The SPR has approximately $584 million in available balance from the Hurricane Katrina Oil Sale in 2005 which is to be used for the repurchase of oil for the Reserve. Following a market assessment in January 2007, the SPR offered bids twice in the Spring of 2007 to acquire oil using these funds, but did not exercise the option to purchase due to unreasonable offers.

DOE plans to utilize the $584 million balance to purchase replenishment oil on the market in Fiscal Year 2008. Before buying additional reserves, DOE will conclude a market assessment and make a determination whether it is a reasonable time to issue a solicitation. The Department will continue to monitor market conditions and thoroughly review responses to solicitations to determine if bids reflect fair market value to the government.

SPR EXPANSION AND ENERGY SECURITY OBJECTIVES

Expansion of the SPR is essential to meeting the Nation's future energy security needs.. It is our intent to increase the level of import protection stored in the SPR as expeditiously as practicable.

The Administration's objectives for the SPR oil fill and energy security are:

- Achieve 727 million barrels in 2009
- Achieve 1.0 billion barrels in 2019
- Achieve 1.5 billion barrels in 2029

It is important to remember that SPR oil is a Government asset. A total of $19.2 billion in federal funding has been provided for acquisition of SPR (or $27.51/bbl). Based on current market prices, the SPR inventory is valued at $62.8 billion (assuming $90.00/bbl)

The amount currently being placed in the SPR of 70,000 barrels per day (as delivered by DOI to DOE, not as placed into the SPR) is less than one-tenth of one percent of the daily global demand of 85 billion barrels per day and is well within producers' existing excess production capacity. The modest fill rate does not put undue pressure on markets. The EIA, Cambridge Energy Research Associates (CERA) and the IEA have repeatedly stated that global oil demand growth and reduced commercial inventories have created tightness in the markets, not the modest SPR fill rate. No empirical evidence exists that would support the suggestion that markets are sensitive to supply changes that the SPR fill rate, 0.05% of world supply, is, or would drive market prices up at any significant level.

Mr. Chairman, and members of the Committee, this completes my prepared statement. I would be happy to answer any questions you may have at this time.

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