

# United States Senate

WASHINGTON, DC 20510

March 6, 2006

Mr. David Walker  
Comptroller General of the United States  
Government Accountability Office  
441 G St., NW  
Washington, DC 20548

Dear Mr. Walker:

The rise in prices of gasoline, diesel fuel, home heating oil and other petroleum products following Hurricanes Katrina and Rita have cast a spotlight on numerous issues central to the energy security of the United States. While these tragic storms had an acute impact on consumers across the nation, we are also aware that recent years have demonstrated a steady run-up in fuel costs, marked by increasing dependence on foreign sources of energy and prolonged periods of price volatility. This volatility, in particular, poses a significant threat to American consumers, businesses and the economic security of the United States as a whole.

As such, we are requesting that the Government Accountability Office (GAO) conduct a comprehensive investigation of these fuel markets, and the factors contributing to increased costs and volatility. In order for a complete picture of volatility in fuel prices to emerge, we request that the following issues should be addressed by any GAO investigation.

**Fuel Inventories:** Fuel is by nature a finite, physical commodity for which demand, at least in the short-term, is relatively inelastic. This is particularly true in instances in which an energy emergency is created by physical supply disruptions—like those caused by this year’s tragic hurricanes. This also seems to be reflected in what some have described as a “fear factor<sup>1</sup>” contributing to rising fuel prices, linked to market expectations and uncertainties about international events.

Recently, the Senate Commerce and Energy Committees heard testimony indicating that the petroleum industry has “moved to a ‘just-in-time’ delivery system, vastly reducing the numbers of refineries nationwide, and minimizing inventories at storage sites (‘tank farms’). The effect is a constant and precarious supply/demand balancing act, which is exceedingly beneficial to industry in lowered operating costs, but very harmful to consumers as supply vulnerability sets the stage for price spikes.<sup>2</sup>”

As such, we believe the following questions should be answered regarding domestic fuel inventories:

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<sup>1</sup> Congressional Research Service, *World Oil Demand and its Effect on Oil Prices*, June 9, 2005.

<sup>2</sup> Testimony of Arizona Attorney General Terry Goddard, Joint Hearing of the Senate Committee on Commerce, Science and Transportation and the Senate Committee on Energy and Natural Resources, November 9, 2005.

- In general, how have inventory levels of crude and refined petroleum products in each U.S. Petroleum Administration Defense District (PADD) varied over the past fifteen years?
  - What factors contribute to differentials in inventory levels across regions of the United States?
  - Moreover, how do these inventory levels vary across seasons?
  - Has this pattern changed over the past fifteen years?
- On a regional basis, what are the historical patterns of U.S. exports of crude and refined petroleum products, and how do these exports vary across seasons?
- How do U.S. inventory levels for crude and refined petroleum products compare to other areas of the world?
- What is the relationship between inventories and fuel price volatility?

**Refining Capacity:** Over the past twenty years, refining capacity in the United States has grown at a slower rate than demand for refined products. During the same period, imports of refined products, including finished gasoline and components used to make gasoline, have increased. In addition, the refinery capacity utilization rate has increased in the United States and it has reached historically high levels in recent years. Insufficient domestic refining capacity has often been cited as a cause of higher or more volatile fuel prices in the United States.

As such, we believe the following questions should be answered regarding the refining industry:

- What factors explain why domestic refining capacity has not kept pace with demand?
- What are the effects of higher refinery capacity utilization rates on fuel prices?
- How do trends in international investment in refining capacity affect the U. S. market for refined products?

**Market Speculation and Transparency:** We have also grown increasingly concerned about the impacts of speculative financial trading on the prices American consumers are paying at the gas pump. In particular, the relationship between trading in financial instruments and the physical prices for petroleum commodities is not well understood. During a series of Senate Commerce and Energy Committee hearings, many questions have been asked of industry participants and both the Federal Trade and Commodity Futures Trading Commissions—with few satisfactory answers provided to date. Among other issues, we thus request that the GAO also attempt to address the following questions:

- Please describe the authorities and responsibilities of federal agencies, including the FTC and CFTC, in protecting American consumers and businesses from volatility associated with speculation in the markets for petroleum commodities and related financial instruments.
- Over the past 15 years, have new “trading platforms” emerged for the sale of wholesale petroleum products and related financial instruments? How do the federal regulatory and transparency requirements differ for the existing array of trading platforms?

- How have major integrated oil companies and refiners participated in these markets over the past 15 years? Do any of the major integrated oil companies and refiners maintain ownership interests in the exchanges on which petroleum commodities or related financial instruments are traded?

These are a handful of the questions that must be answered to gain a more complete understanding of the factors contributing to the volatility of domestic fuel prices. At the conclusion of an inquiry into these matters, we hope the GAO will also make recommendations designed to curb volatility of domestic petroleum prices, ensure sufficient transparency of these markets. We are happy to work with you and your staff on a schedule and major milestones for this investigation. Thank you for your attention to this request and please do not hesitate to contact our staff should you have questions regarding this request.

Sincerely,



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