

The fuel and the furor

Straight talk about rising gasoline prices **Interviewed by Arthur G. Sharp**

Astronomical gasoline prices are a punch in the budget, as business owners who depend on moving their products to market know. As consumer demand climbs, and as oil producers, refiners and distributors struggle, supply shows no significant or immediate hope of increase.

One long- and short-term tactic for business owners is to bulk-buy or sign long-term distributor contracts. They can also use alternative fuels such as propane and diesel, and reduce company vehicle use. As they do, it may turn out that prospects are not as grim as they sound today. However, the return of cheap and easy-to-find crude oil is not likely to return any time soon, if ever.

Smart Business spoke with John Barnes, chairman and CEO of B&R Energy LLC, about the pump fees and business fears, changes that recovery may bring, the hidden costs in refining and gasoline distribution, and possible improvements in future supply and prices.

What's causing all the price drama at the pumps?

No one thing ever drives pump prices. Behind every new number at the local station is a line of government and EPA regulations, drilling and exploration costs, reduced storage and refining facilities, and the shortage of ethanol — mandated by governmental regulations to be mixed with gasoline by summer 2006 to reduce pollution.

Add to that the unstable global geo-political issues that affect supplies and free-market pressures driving prices steadily upward, and you soon discover that combined factors affect us all.

How does ethanol play into prices at the pump?

Ethanol is an oxygenate that, mixed with gasoline, reduces ozone haze and smog. Not only is it currently in short supply, but it's always costly and it's a negative-energy product. That is, it provides less energy than it costs to make. There is also a large tariff on imported ethanol. One national



John Barnes
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distributor I know of recently paid more for the ethanol to mix in its gasoline than for the gasoline itself.

Another problem with ethanol is getting it from A to B. Gasoline and most oil-refinery products travel by pipeline, but since ethanol tends to absorb water from the atmosphere, it has to be trucked or shipped by rail and mixed at the local gasoline distributor's site. Obviously, any transportation delays of the ethanol can also cause spot shortages of gasoline — which also affects gasoline availability and prices.

Does this imply that an adequate supply of ethanol would help stabilize gasoline prices?

There's more to it even than supply. While ethanol does a good job of oxygenating gas and cutting pollution, a high mix of it with gasoline also reduces miles per gallon. In other words, we use more gasoline to drive the same number of miles — which also affects gasoline availability and overall costs per gallon.

As one local gasoline refiner reported this week, 'Ethanol is good for my business; when I have fuel to sell I get more for it, and since it does not do as good a job in cleaning fuel injectors and pumps, I'll get more repair business.'

How do refining costs and utilization influence gasoline costs?

Over the past 20 years, in every single year except for the last five, the refining industry has lost money. For the past 20 years, Congress has burdened the industry with billions of dollars in environmental costs on refiners who lacked the profits to cover them. Smaller refineries that were required to spend hundreds of millions of dollars to stay in business lost money and had no choice but to shut down.

Capital markets are not kind to companies losing money. The only profitable oil-related companies were those involved in production, and even they weren't making much then. Today, we have roughly the same refining capacity of 20 years ago, spread over half the number of refineries. No new refineries have been permitted to be built.

How do demand and supply affect prices?

Although U.S. refineries have maintained their capacity with expansion off-setting closings, we can import gasoline and other products as we do oil. However, supplies of oil and oil-derived products have ceased to grow and demand continues to grow rapidly. As oil supply has tightened, oil prices have risen to bring supply and demand into balance. Higher oil prices bring higher gasoline prices.

Are there any bright spots?

Researchers are working with cleaner diesel fuels, which are a bit more fuel efficient, and biodiesel, which is energy-efficient and can supplement or replace some diesel usage. Hybrid cars, electric cars and more fuel-efficient cars can also mitigate oil demand. The search is on for positive-energy fuels that provide more energy than they cost to make. In that respect, a shift to diesel and a growth in biodiesel fuels does look promising.

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