

Approved: March 30, 2000

Date

Carl Dean Holmes

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairman Carl D. Holmes at 9:15 a.m. on March 22, 2000 in Room 231-N of the Capitol.

All members were present.

Committee staff present: Lynne Holt, Legislative Research Department
Mary Torrence, Revisor of Statutes
Jo Cook, Committee Secretary

Conferees appearing before the committee: Janette Luehring, Kansas Corporation Commission
Rep. Carlos Mayans, 100th District
Bob Krehbiel, Kansas Independent Oil & Gas Assn.

Others attending: See Attached Guest List

HR 6016 - Requesting the Corporation Commission to study and report on deployment of advanced telecommunications services

Chairman Holmes welcomed Janette Luehring, Chief of Telecommunications for the Kansas Corporation Commission, who presented testimony in support of **HR 6016 (Attachment 1)**. Ms. Luehring stated that this task force would provide input on incentives and mechanisms to facilitate the deployment of advanced services to those unserved areas.

Ms. Luehring responded to questions from Rep. Sloan

Chairman Holmes opened the debate. Rep. McClure moved to change line 30 to show that a member of the KCC staff will serve as the chairperson. Rep. Alldritt seconded the motion. Motion carried. Rep. McClure moved to adopt a balloon that would add an additional request for the Commission to identify local exchanges that are nearing capacity and services that could be impaired if not upgraded. Rep. Long seconded the motion. Motion carried. Rep. Alldritt moved to adopt a balloon that would cause the Commission to withhold action on a Southwestern Bell docket until certain investments have been made. Rep. Krehbiel seconded the motion. Motion failed. Rep. McClure moved to recommend **HR 6016**, as amended, favorable for passage. Rep. Dahl seconded the motion, motion carried.

HR 6014 - Requesting study of increasing costs of petroleum products

Rep. Holmes reopened the hearing on **HR 6014** and welcomed Rep. Carlos Mayans, lead sponsor of the resolution. Rep. Mayans explained his reasoning for the drafting of the Resolution. He outlined the impact on parents and law enforcement.

Rep. Mayans responded to questions from Rep. Vining, Rep. O'Brien, Rep. Loyd and Rep. Krehbiel.

Bob Krehbiel, Kansas Independent Oil & Gas Assn., distributed copies of a press release from the John S. Herold, Inc. (Attachment 2). The press release showed prices of a gallon of gas in relation to prices for a gallon of other consumer products, proclaiming that oil is cheap. He also included the average prices of a barrel of crude oil in Kansas over the past six years. He stated that this firm studies the oil and gas industry and makes recommendations to Wall Street by studying the markets in depth. Mr. Krehbiel also stated that the Senate Energy and Natural Resources Committee has requested a study of energy policy as an interim topic. Mr. Krehbiel suggested that this would be an appropriate topic for the study.

The conferees responded to questions from Rep. Vining, Lynne Holt, Rep. McClure, Rep. Dahl, Rep. Morrison, Rep. Krehbiel, Rep. Sloan, Rep. Loyd, and Rep. O'Brien.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES in Room 23-N on March 22, 2000 at 9:15 a.m.

Rep. McClure suggested to the committee that since there is not an energy policy at either the state or federal level, this resolution could be used as a vehicle to take some of the language from **HB 2497** as it pertains to membership of task force and possible study topics. The new resolution would include portions of **HR 6014**. Chairman Holmes asked for volunteers from the committee to work on a substitute resolution.

Rep. Long moved to approved the minutes of the March 1, March 2, March 6, March 7, March 8 and March 9 meetings. Rep. Compton seconded the motion. Motion carried.

Chairman Holmes announced this would be the last regular committee meeting.

Meeting adjourned at 10:29 a.m.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: March 22, 2000

| NAME | REPRESENTING |
|------------------|--------------|
| Rob Hodges | KTIA |
| Doug Lawrence | SW Bell |
| Tom Day | KCC |
| Guy McDonald | KCC |
| Janette Luehring | KCC |
| Scott Schneider | MGA |
| Mike Lopez | ATT |
| Mike Murray | SPRINT |
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House Utilities Committee
Comments of the Kansas Corporation Commission Staff
on House Resolution No. 6016
March 22, 2000

The purpose of the resolution would be to identify areas that do not have advanced telecommunications services currently available, or will not have advanced services available in the near future, and to form a Task Force to allow interested persons to have input on recommendations regarding the deployment of advanced services in the identified unserved areas.

Information regarding the deployment and planned deployment of advanced services would be provided to the Commission. All advanced service providers should provide such information in order to create a complete picture of the status of advanced service deployment throughout the state. The Commission Staff would review the information and provide the aggregated information to the Task Force. The company specific data would not be provided to the Task Force, which should mitigate any concerns regarding the possible confidential nature of the information.

The Task Force, which would consist of participants representing the various telecommunications industries, would provide input on incentives and mechanisms to facilitate the deployment of advanced services to those unserved areas.

The recommendations of the Task Force would be provided in a report to the legislature submitted at the beginning of the 2001 legislative session.

HOUSE UTILITIES

DATE: 3-22-00

ATTACHMENT 1



Press Release

FOR IMMEDIATE RELEASE

For further information:
Tom Sommers or A.D. Koen
(713) 752-1900

AT NEARLY \$30.00/BBL, OIL IS CHEAP!

Herold Study Shows that Oil is Still the Cheapest Item in a Typical Consumer's Shopping Basket

February 11, 2000 Stamford, CT – A just-released research analysis by petroleum research company John S. Herold, Inc. refutes the highly-charged, widely-held view that oil companies get rich at the expense of consumers who pay, from time to time, “exorbitantly high” prices to fill their tanks. In reality, according to the study, oil prices today, adjusted for inflation, are roughly equivalent to early 1970s levels!

More than one decade after Herold first proclaimed *OIL IS CHEAP*, nothing has changed, the report says. Currently flirting with the \$30.00/barrel (bbl) price level, oil remains the cheapest item in a typical consumer's shopping basket. Herold's analysis compares the price of crude oil and gasoline to items in a typical consumer's shopping basket such as Evian water, Ben & Jerry's “Chunky Monkey” ice cream, and milk.

The case for cheap oil is more compelling considering relative “utility” which, literally, attempts to value the mileage from a certain commodity. One gallon of gasoline equates to an average of 20 miles. However, one gallon of Coca-Cola provides enough energy, or calories, to walk at a comfortable pace for only 14.1 miles. Meaning, one gallon of gasoline allows you to travel 42% farther at a one-third lower cost!

Not surprisingly, politicians display a strong interest in low gasoline prices during election years, the petroleum research company says. Strangely enough, many of the same politicians citing “dangerously high oil prices” were silent one year ago when the oil market tanked, plunging 1998 gasoline prices, in real terms, to the lowest levels in 64 years.

The oil industry is extremely volatile, and while oil prices are strong now, history shows that for every peak, there is a trough. Herold believes that oil today is not expensive at all in historical terms -- and it wouldn't be unreasonable for prices to trend higher this year. After all, the passing of time – with inflation and increased costs – results in higher prices for almost all consumer goods. Herold questions whether it's fair for the public to expect perennially low prices during the oil industry's profitable times – and remain silent during the hard times.

HOUSE UTILITIES

DATE: 3-22-00

ATTACHMENT 2

Gasoline is a Great Value

According to the American Automobile Association, at today's average price of \$1.29 per gallon, gasoline is cheaper than its recent-year peak price of \$1.38 per gallon experienced in 1990 during the Persian Gulf crisis. However, adjusted for inflation, today's gasoline prices are 12% lower than the 64-year historical average of \$1.46 per gallon, while auto mileage efficiency has increased over the past 20 years. In other words, consumers now pay one-third less for each mile than the historical average of \$0.09/mile.

| JSH Shopping Basket | | | | | |
|---|-----------|-------------|----------|--|----------------|
| Product | Price | Normal Size | Volume | | Price per Bbl. |
| Crude Oil (Arab Light FOB)*** | \$26.28 | 1 Barrel | 5376 Oz. | | \$26.28 |
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| Coca Cola | \$0.99 | 2 Litre | 67.6 Oz. | | \$78.73 |
| Poland Spring Water | \$0.89 | 1.5 Litre | 50.7 Oz. | | \$94.37 |
| Milk | ↑ \$1.79 | .5 Gallon | 64 Oz. | | \$150.36 |
| Evian | ↑ \$1.79 | 1.5 Litre | 50.7 Oz. | | \$189.80 |
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| Perrier | ↑ \$2.79 | 4 pack | 44 Oz. | | \$340.89 |
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| Pinot Grigio (Italian White Wine) | \$12.99 | 1.5 Litre | 50.7 Oz. | | \$1,377.40 |
| Head & Shoulders Shampoo | ↑ \$4.59 | 15.2 Oz. | 15.2 Oz. | | \$1,623.41 |
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| Flonase (Prescription Nasal Spray) | ↑ \$64.59 | 16 Grams | 0.56 Oz. | | \$615,240.95 |

*based on "AAA" U.S. Avg. retail \$1.29/gal at 1/18/00

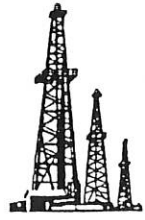
** new additions

***spot prices at 1/26/00

Source: John S. Herold, Inc.

Herold is a 50-year-old petroleum research company specializing in company valuations, with offices in Stamford, Houston, and Dallas. In addition to Equity, Mergers & Acquisitions, Company Strategic and Fixed-Income analysis and Consulting services, Herold offers the oil industry's most comprehensive online Financial and Operations and M&A databases.

For further information about or to receive a copy of "At Nearly \$30.00/bbl, Oil is Cheap! And We Stand By That..." please contact Tom Sommers or A.D. Koen at (713) 752-1900.

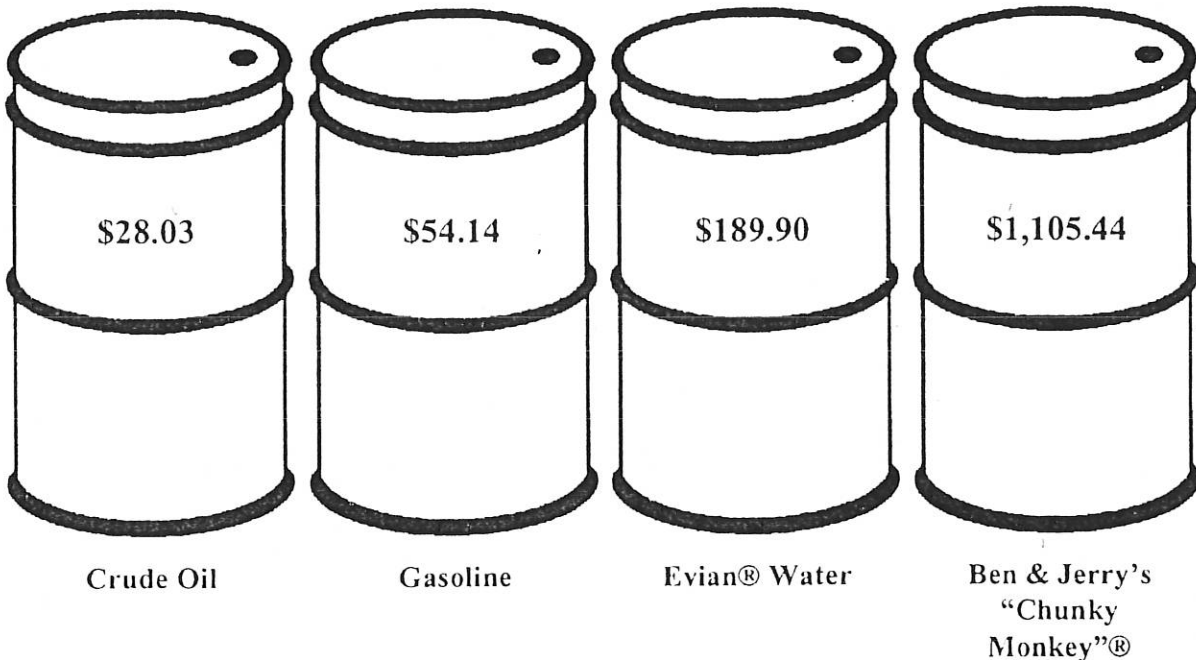


Herold Industry Studies, Special Reports and Analyses

Aliza C. Fan
Arthur L. Smith, CFA
Sven del Pozzo
Linda Wallimann
February 10, 2000

**AT NEARLY \$30.00/BBL, OIL IS CHEAP!
AND WE STAND BY THAT...**

Relative Prices per 42-Gallon Barrel



More than one decade after Herold first proclaimed *OIL IS CHEAP*, nothing has changed! Currently flirting with \$30.00/bbl, oil remains the cheapest item in our shopping basket.

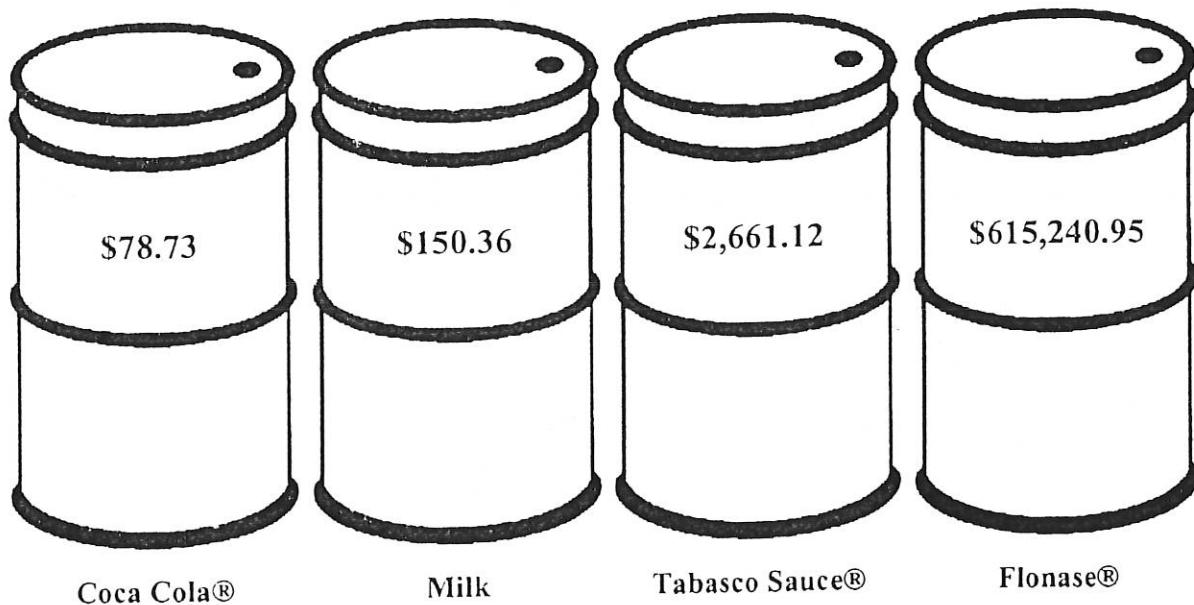
Not surprisingly, politicians display a strong interest in low gasoline prices during election years. Strangely enough, many of the same politicians citing "dangerously high oil prices" were silent one year ago when the oil market tanked and 1998 gasoline prices, in real terms, plumbed the lowest levels in 64 years. This report's goal is to provide analysis and refute the highly-charged, widely-held view that oil companies get rich at the expense of consumers who pay, from time to time, "exorbitantly high" prices to fill their tanks.

In reality, oil prices today, adjusted for inflation, are roughly equivalent to early 1970s levels! Moreover, not only is gasoline relatively cheap, but the preponderance of oil companies have failed to turn a decent profit over the past five years. During the current period of great U.S. economic expansion, many oil company share prices are lower than 1994 levels.

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In 1989, Herold Chairman and CEO Arthur L. Smith first boldly stated that *OIL IS CHEAP!* -- based on innovative analysis of the relative cost of gasoline versus other commodities in a typical consumer's shopping basket. In 2000, we're sticking to our guns to proclaim *OIL IS CHEAP*, even amid oil prices close to a nine-year high. Our case is more compelling when we consider relative "utility" which, literally, attempts to value the mileage from a certain commodity. One gallon of gasoline equates to 20 miles. However, a gallon of Coca-Cola provides enough energy, or calories, to walk at a comfortable pace for only 13.6 miles! (Details to follow)

Admittedly, Herold as an independent oil and gas research company has a pro-petroleum bias. Looking at the big picture, in our 50-year history, we've witnessed economic recession and expansion and social unrest. However, one constant view is that American energy consumers feel an entitlement: the right to buy cheap fuel. Gasoline prices rising above a comfort level (which frequently is prices during the commodity's most recent cyclical trough) results in public protest. Indeed, the oil industry's image problem makes it an easy target for consumers and government officials. "Big Oil" is a perennial topic among politicians, as noted in recent Presidential Candidate debates, especially for candidates who can risk alienating the handful of active oil-producing states. Herold concedes that the oil industry, with more than a 100-year history, has learned some lessons in environmental responsibility. In the same vein, U.S. oil executives are responsible managers, as evidenced by their successes in entering numerous countries previously closed to foreign investment.

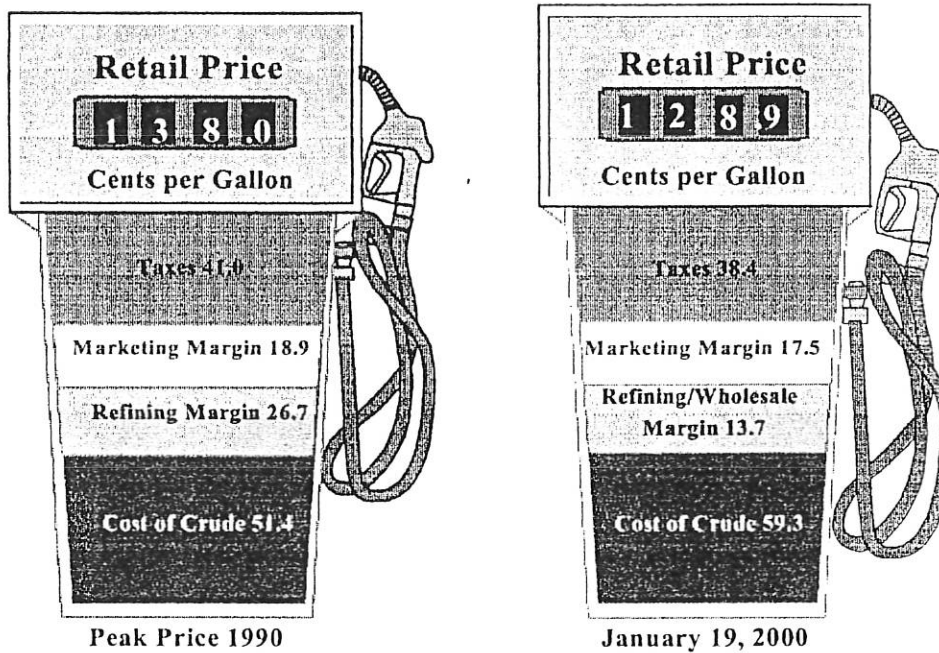


GET MORE GAS FOR THE BUCK...

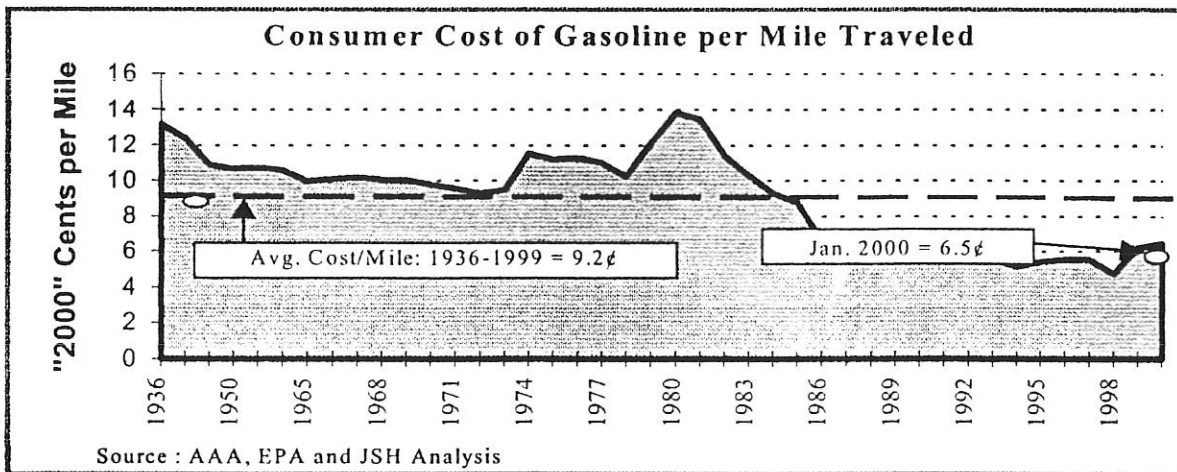
According to the American Automobile Association, at today's average price of \$1.29 per gallon, gasoline is cheaper than its recent-year peak price of \$1.38 per gallon experienced in 1990 during the Persian Gulf crisis. (See gasoline pump below) However, adjusted for inflation, today's gasoline prices are 12% lower than the 64-year historical average of \$1.46 per gallon, while auto mileage efficiency has increased over the past 20 years. Consumers now pay one-third less for each mile than the historical average of \$0.09/mile.

More recently, consumers have paid higher total gasoline bills due to the popularity of less fuel-efficient large sport utility vehicles. Miles per gallon has trended down since 1997. The severity of the 1998 oil market meltdown is evidenced by the nominal \$0.97/gallon price average for that year -- the lowest ever.

Federal and state taxes now account for one-third of gasoline prices. Connecticut, among states with the highest gasoline tax rate, is currently calling for about a 20% decrease in gasoline taxes.



Source: AAA, EIA, JSH analysis and estimates



Source : AAA, EPA and JSH Analysis

Consumer Cost of Gasoline per Mile Traveled (\$2000)**

| Year | Cost per Mile cents | Retail Gas Price cents/gallon | Miles per Gallon mpg* |
|-------------|--------------------------------|--|----------------------------------|
| 1936 | 13.19 | 201.6 | 15.29 |
| 1940 | 12.39 | 189.5 | 15.29 |
| 1945 | 10.91 | 164.1 | 15.04 |
| 1950 | 10.70 | 160.0 | 14.95 |
| 1955 | 10.76 | 156.3 | 14.53 |
| 1960 | 10.61 | 151.5 | 14.28 |
| 1965 | 9.98 | 142.5 | 14.27 |
| 1966 | 10.11 | 142.6 | 14.11 |
| 1967 | 10.18 | 143.2 | 14.07 |
| 1968 | 10.06 | 139.6 | 13.87 |
| 1969 | 10.04 | 136.8 | 13.62 |
| 1970 | 9.80 | 132.5 | 13.52 |
| 1971 | 9.57 | 129.6 | 13.54 |
| 1972 | 9.29 | 124.5 | 13.40 |
| 1973 | 9.47 | 125.9 | 13.30 |
| 1974 | 11.58 | 155.5 | 13.42 |
| 1975 | 11.23 | 151.9 | 13.52 |
| 1976 | 11.31 | 153.0 | 13.53 |
| 1977 | 11.06 | 152.6 | 13.80 |
| 1978 | 10.26 | 144.1 | 14.04 |
| 1979 | 12.15 | 175.0 | 14.41 |
| 1980 | 13.81 | 213.5 | 15.46 |
| 1981 | 13.45 | 214.4 | 15.94 |
| 1982 | 11.49 | 191.3 | 16.65 |
| 1983 | 10.34 | 177.2 | 17.14 |
| 1984 | 9.32 | 166.2 | 17.83 |
| 1985 | 8.80 | 160.1 | 18.20 |
| 1986 | 6.70 | 122.3 | 18.27 |
| 1987 | 6.32 | 121.4 | 19.20 |
| 1988 | 5.90 | 117.3 | 19.87 |
| 1989 | 6.06 | 123.2 | 20.31 |
| 1990 | 6.38 | 134.1 | 21.02 |
| 1991 | 5.83 | 126.5 | 21.69 |
| 1992 | 5.64 | 122.2 | 21.68 |
| 1993 | 5.56 | 117.0 | 21.04 |
| 1994 | 5.13 | 114.1 | 22.24 |
| 1995 | 5.40 | 113.9 | 21.10 |
| 1996 | 5.55 | 118.3 | 21.30 |
| 1997 | 5.54 | 115.9 | 20.92 |
| 1998 | 4.75 | 97.4 | 20.50 |
| 1999 | 6.20 | 124.0 | 20.00 |
| Jan 2000 | 6.45 | 128.9 | 20.00 |
| Avg. | 9.19 | 145.77 | 16.86 |

*Source: EIA, EPA, DMV

**Source: DOL (CPI for all urban consumers, not seasonally adjusted)

**GASOLINE GETS YOU THERE CHEAPER AND FASTER –
WITH LESS SWEAT!**

Supply and demand set the price in the marketplace, the best indicator of the value of a commodity at a particular point in time. This concept doesn't always seem to apply to the oil market as consumers seem to want to drive more and pay less for gasoline. Herold clients are probably familiar with our 50-year-old methodology for appraising an oil and gas company. We applied our approach to value the "utility" of a commodity – literally, the mileage from one gallon of Coca-Cola and gasoline!

Price per gallon (128 oz):

Coca-Cola \$1.87

Gasoline \$1.29

Assumptions:

- Coca-Cola: 12.5 calories per ounce or 1,600 calories per gallon
- According to onhealth.com, a 160-pound person walking 3 miles per hour will burn 342 calories.
- It takes 4.7 hours to "work-off" 1,600 calories walking at 3 mph.
- Therefore, 1,600 calories provide enough energy for a person to walk 4.7 hours at 3 mph or 14.1 miles.
- One gallon of gasoline provides enough energy for a vehicle to travel an average of 20 miles.

Conclusion:

One gallon of gasoline allows you to travel 42% farther at a one-third lower cost than Coca-Cola plus, it's a lot less work and sweat! On the other hand, Diet Coke, with zero calories, won't give you the energy to get very far at all.

GASOLINE -- A GREAT RELATIVE VALUE

Once again, crude oil and gasoline are the cheapest liquids consumers purchase. Our research focuses on relative valuation of the price of oil and gasoline to other liquids. For comparability, we convert the price and quantity of each product to a per barrel equivalent. By comparing all items on the same basis, we can determine the inherent value of a product.

Key findings from our shopping trip:

- If you're an avid drinker of **Evian** water, you're better off to fly to France, hike up the French Alps, and get the water yourself. A recent weekly US Airways Internet special offered roundtrip fares from Hartford, CT to Paris, France for only \$258.00. A barrel of Evian costs \$189.80. In other words, by getting the French water yourself, you can go on your dream vacation for only \$68.20! (if you stay in a tent, rather than a hotel). Or better yet, drink tap water and save \$189.68/bbl (The price for one barrel of residential water in the Houston, Texas area is \$0.12.) If you're wary of contaminants, invest \$40.00 in a water filter.
- Even better news for **Perrier** drinkers. Forgo the bubbles, drink tap water, and save \$340.77/bbl, which will buy you the French trip, a couple of nights in a B&B, plus the water filter!
- Allergy sufferers -- we hope you've opened up a mutual fund to keep your **Flonase** supply flowing. For a cool \$615,241, you can purchase one barrel of Flonase (which could be your lifetime supply if you live in the South). Flonase's price is up 150% since our 1998 study, the sharpest increase of all the liquids we sampled.
- Oh, how unfair life is... Dandruff sufferers not only have to deal with the embarrassment of white flecks on the black Armani suit, you also have to shell out 15% more this year for **Head & Shoulder's Shampoo** since our last study in 1998. That's an extra \$212.00/bbl, the cost of a Shampoo, Cut and & Blowdry at a tony Greenwich, CT salon.

- In addition to flying to France for clean drinking water, another Herold Cost Savings Tip is to invest in a homemade ice cream maker, buy bananas and milk, family-size baking chocolate and walnuts and turn your kitchen into an ice cream factory. The milk will cost you \$150.00/bbl. But savings from making your own, rather than buying **Ben & Jerry's "Chunky Monkey"** Ice Cream, total \$955.08/bbl – plenty extra to buy ice cream supplies and ingredients.
- We acknowledge that consumers consider gasoline a necessity, thus, expect lower prices compared with luxuries such as Evian water and **Pinot Grigio**. However, gasoline is still a relative bargain to staples such as **Milk** and **Orange Juice**.

| JSH Shopping Basket | | | | | |
|---|-----------|-------------|----------|--|----------------|
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Source: John S. Herold, Inc.

* based on "AAA" U.S. Avg. retail \$1.29/gal at 1/18/00

** new additions

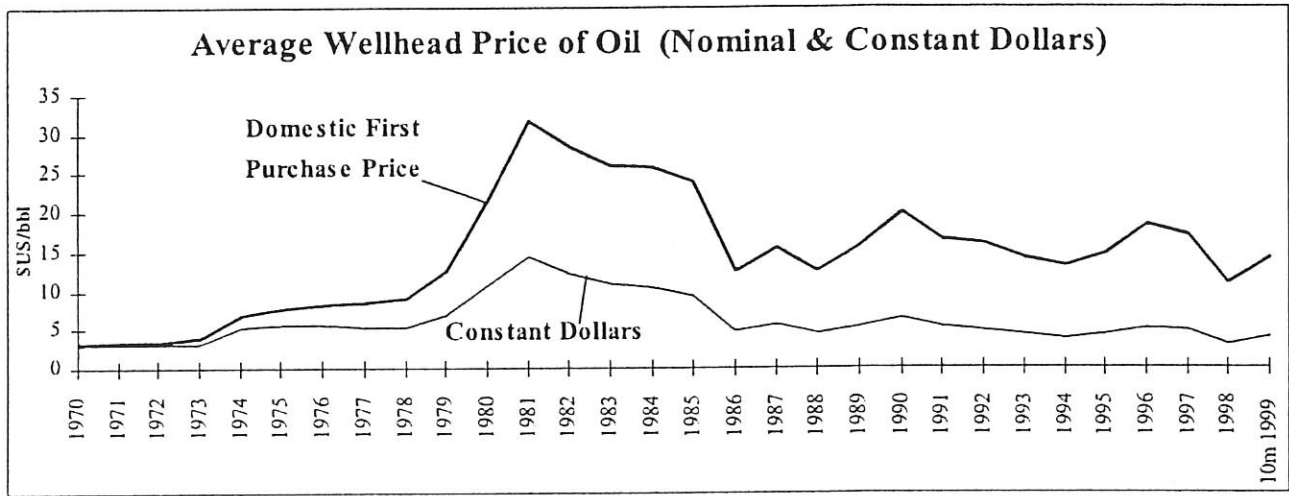
***spot prices at 1/26/00

Now that we've done some relative analysis of oil price and gasoline compared with common items in our shopping basket, we'll address some common myths and misconceptions regarding the oil industry.

OIL IS CHEAP!

Perception: Oil is Expensive! It's ridiculous I have to spend \$1.29 per gallon at the pump when I paid \$0.97 one year ago.

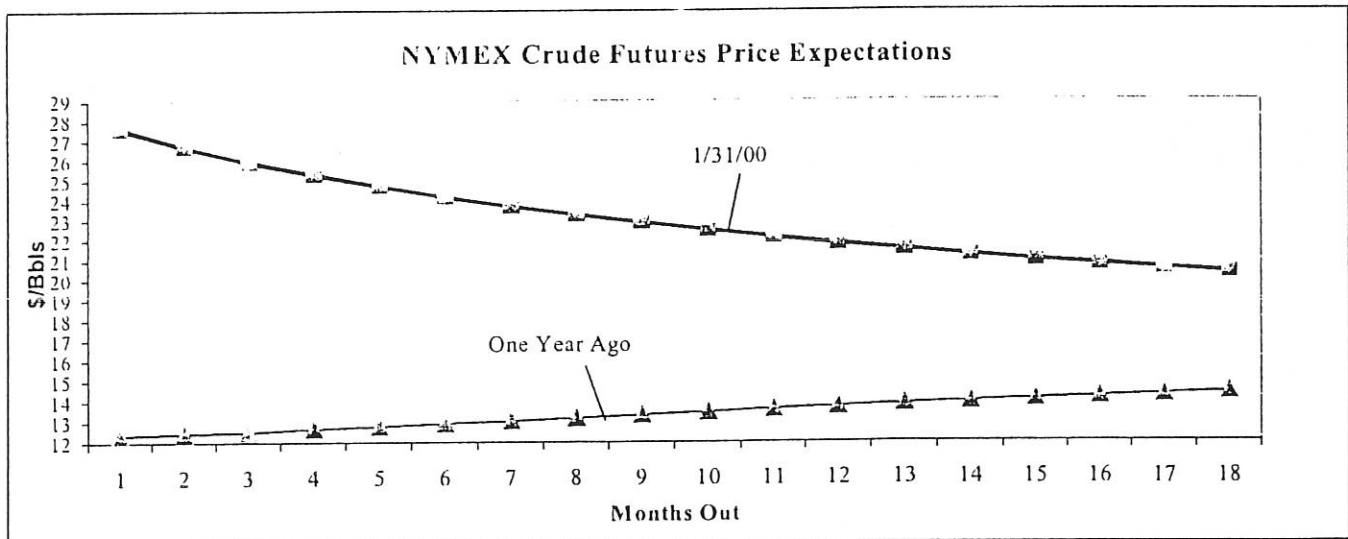
Analysis: Crude oil at \$28.03/bbl is the cheapest liquid commodity (next to tap water) especially when compared with items in a typical consumer's shopping basket. Certainly there are times when gasoline prices are relatively more expensive as compared with depressed prices during a cyclical trough. Therein lies the key to this issue: Oil is a commodity that is extraordinarily volatile or "manic-depressive." During one year, oil companies can be flush with profits, the next; companies can be on the brink of bankruptcy.



Source: John S. Herold, Inc.

As the graph above shows, nominal 1999 oil prices were within the 10-year range, while the constant price for oil (adjusted for inflation) has trended downwards and is actually roughly equivalent to the early 1970s level! Nominal prices are what producers receive for oil, which exclude transportation costs.

The current oil price environment has indeed cyclically strengthened in recent months. However, Herold would not term the current oil market "overheated" relative to historical levels and other commodities. The cyclical nature of the oil market is preordained. As the graph below shows, consumer expectations are that future oil prices will revert toward the mean of under \$20.00/bbl.



Source: John S. Herold, Inc.

Favorable fundamentals and positive stock market psychology periodically converge in "manic" petroleum markets, as was the case in 1997 and from mid-1999 to the present. Oil prices are strong. The

2-9

supply and demand picture implies relatively healthy demand for petroleum products. OPEC adheres to production quotas. The outlook of the Asian economy is more optimistic than negative. The results: strong oil prices and firm gasoline prices versus one-year ago.

On the flip side, factors can diverge, such as the 1998 "depressed" market. Supply and demand is imbalanced, flush with inventory in the wake of uneconomic spending and drilling. The Asian economic malaise lowers demand. Integrated oils such as Exxon and Mobil and BP, Amoco and Arco consolidate to remain competitive. Exploration and Production (E&P) companies lay off employees, sharply reduce spending, sell properties, consolidate, put their companies on the block, while others file for bankruptcy. Lower oil prices result in: reserve writedowns; lower company valuations; negative or negligible net income – prompting dramatically lower share price returns. Herold described the 1998/99 oil market a meltdown, with oil prices plummeting at the fastest rate of recent history.

Against this backdrop, we wonder whether it's realistic or fair for consumers to expect and demand sustained cheap gasoline prices – under an environment in which it's virtually impossible for oil companies to stay in business. The irony is that during the bloody 1998 oil market, we didn't witness a public outcry to lend support to the ailing oil industry. We didn't read much about the broader implications of "dangerously low oil prices," which could trigger economic chaos and political instability in countries that strongly depend on oil revenues. While local oil towns newspapers and financial news services honed in on the industry's hardships – we were hard-pressed to find compelling coverage by the mainstream press. Nor can we recall politicians and consumers offering a "rebate" to oil companies during a low oil price environment to help during tough times. This would be a consistent if consumers demand cheap oil, and airline companies tack on a "fuel surcharge" during a strong oil price environment.

OIL INDUSTRY IS DOMINATED BY "LITTLE GUYS"

Perception: Oil companies are multi-billion dollar corporations. Maybe I'd be willing to pay more for gasoline if it benefits "mom and pop" companies.

Analysis: Mom and pop companies are the foundation of the oil industry. Integrated oils or "Big Oil" represent a small fraction of the total number of oil and gas companies. The Independent Petroleum Association of America (IPAA), which represents public and private companies that only explore for and produce oil and gas, has 8,000 members. The typical independent has been in business 25 years, employs 11 full-time and 2 part-time people, with median gross revenues of \$4 million – hardly a large corporation. IPAA also works with regional associations that represent thousands of royalty owners and oilfield service companies. As for "Big Oil," there are approximately 17 publicly traded integrated oil companies, and a smattering of privately held large integrated oils.

INDEPENDENT OIL COMPANIES DON'T MAKE MONEY

Perception: Oil companies make too much money. Why can't I get a piece of the profits through lower gasoline prices?

Analysis: Our analysis shows the nine-year U.S. economic boom has not flowed through to oil companies' coffers. In fact, total return on capital employed (ROCE) which measures a company's returns in relation to the amount of capital invested is a sub-par .04% among a group of large independent oils from 1994-1998. During the same period, share prices of the group were down 4%. The story isn't much better for companies that refine oil and market gasoline. We found that independent refiners &

marketers' five-year ROCE of 1.2% only slightly better than E&P companies, anemic compared to the margins of many industrial sectors.

Now, arguments can be made that oil company woes are due to inefficient use of capital, not just because of volatile oil prices; and integrated oils have been profitable. Points well taken, and with which we wholeheartedly agree... but we'll save that analysis for a future Herold research analysis.

SUMMARY

We hope we've objectively stated our case that OIL IS CHEAP and addressed common perceptions of the industry and prices. The oil industry is extremely volatile, and while oil prices are strong now, history shows that for every peak, there is a trough. Herold believes that oil today is not historically overvalued at all -- and it wouldn't be unreasonable for prices to trend higher this year. After all, the passing of time -- with inflation and increased costs -- results in higher prices for almost all consumer goods. Herold questions whether it's fair for the public to expect perennially low prices during the industry's profitable times -- and remain silent during the hard times.

Kansas oil producers see promise at the pump

Long-silent oil wells in Kansas are operating again.

By CHRIS GRENZ
The Capital-Journal

GREAT BEND — As an independent oil producer, Danny Biggs is annoyed when he pulls into a service station and hears grumbling about the price of gasoline.

He has seen people driving huge sport utility vehicles that get 12 miles to the gallon complain about spending \$1.30 per gallon on gas — and then chase the comment with a swig of water from a 16-ounce bottle that cost \$1.25.

"You're always going to hear people complain about the gas price," Biggs, of Great Bend, said Tuesday. "It just really frustrates me. The gasoline (price) is something that just really gets to people. Folks, you're still getting a good deal. We're very lucky."

After nearly two years of recession, Kansas oil producers are finally seeing some luck, too.

Biggs, president of the National Stripper Well Association, said higher prices at the pump translate into jobs and income for Kansas oil producers who weathered such a slump in crude oil prices that many longtime producers left the business.

"We've gone back to work," Biggs said. "We've started our wells back up. Now we're exploring for oil for American production."

Biggs has testified before the U.S. Senate Energy and National Resources Committee and spoken to the U.S. Department of Energy about prices that fell as low as \$7.75 per barrel. A

producer needs to make about \$20 a barrel just to break even, he said.

"I've been in the business 45 years and it was the worst I've ever experienced," Biggs said of the 18-month recession. "The effect it was having on us was it put a lot of people out of business. We lost a lot of good people."

By contrast, when he checked the price Tuesday morning, oil was selling for \$26.75 per barrel.

"This morning it was as high as I've seen it in a long time — since probably the early '80s," he said. "People right now are cautiously optimistic. We hope that the prices stay up."

As editor of the newspaper in Lyons, which is about 30 miles east of Great Bend in Rice County, John Sayler editorializes about the price of oil regularly. Sayler was optimistic about the higher prices.

"It's very encouraging to people whose lives are invested in oil," he said. "What it's going to eventually generate here is the return of the oil industry."

Like Biggs, Sayler has seen many oil producers driven out of business by rock-bottom prices. Now, he is seeing Rice County wells operate that have long stood silent and drilling in areas that had been abandoned.

"I don't think we've seen a rig running in the county in two or three years, where it used to be you'd see them on every horizon," he said. "I don't know if we'll see that again. It's just kind of struggling back to life at this point."

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—Allen H. Neuharth, Founder, Sept. 15, 1982

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Rising oil prices fuel a pointless backlash

No sooner had energy prices spiked in January than lawmakers started pounding the table demanding action.

How could the price of home heating oil nearly double in just 10 days, Sen. John Kerry, D-Mass., demanded to know. It "appears to be too fast and too large to be based on demand and supply alone," he said, in calling for a federal probe.

Kerry isn't the only one wondering. The price of a barrel of oil is up about \$15 from a year ago, according to the Department of Energy. Consumers are feeling the brunt, whether it's to heat their homes or fill their tanks. Gasoline prices jumped almost 50 cents in six days in New Hampshire. Overall, they're expected to climb to \$1.40 a gallon. That has prompted pressure on the White House to dampen prices by selling off some of the Strategic Petroleum Reserve. So far the administration has resisted, saying the market should set prices.

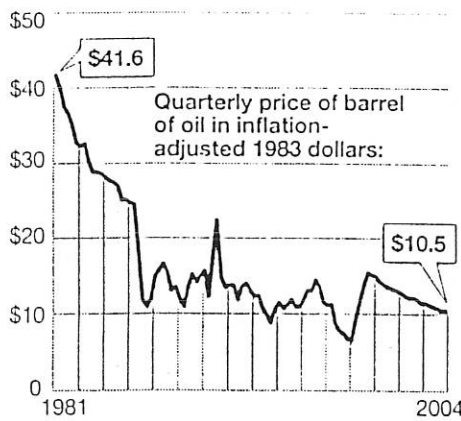
That's the right response. If history is any indication, today's painful cost hikes will be followed by falling prices, even without any help from Washington. If you don't think so, look at what happened just four years ago.

The spring of 1996 saw a big jump in prices, with calls for investigations and a petroleum reserve sell-off. But the investigations didn't turn up anything out of the ordinary. The spike was due to temporary supply-and-demand imbalances. And prices started falling soon enough all on their own, hitting all-time lows by 1998.

What is already known about the recent price spike suggests a repeat of that. An unexpectedly cold winter — 20% colder than normal in New England — caught suppliers and consumers by surprise, quickly pushing up demand for heating oil. And some commercial users were forced to buy oil instead of natural gas, which helped dry up supplies.

Slippery slope

Prices for oil look high today, but they are low by historical standards and are most likely to continue falling.



Source: Standard & Poor's DRI

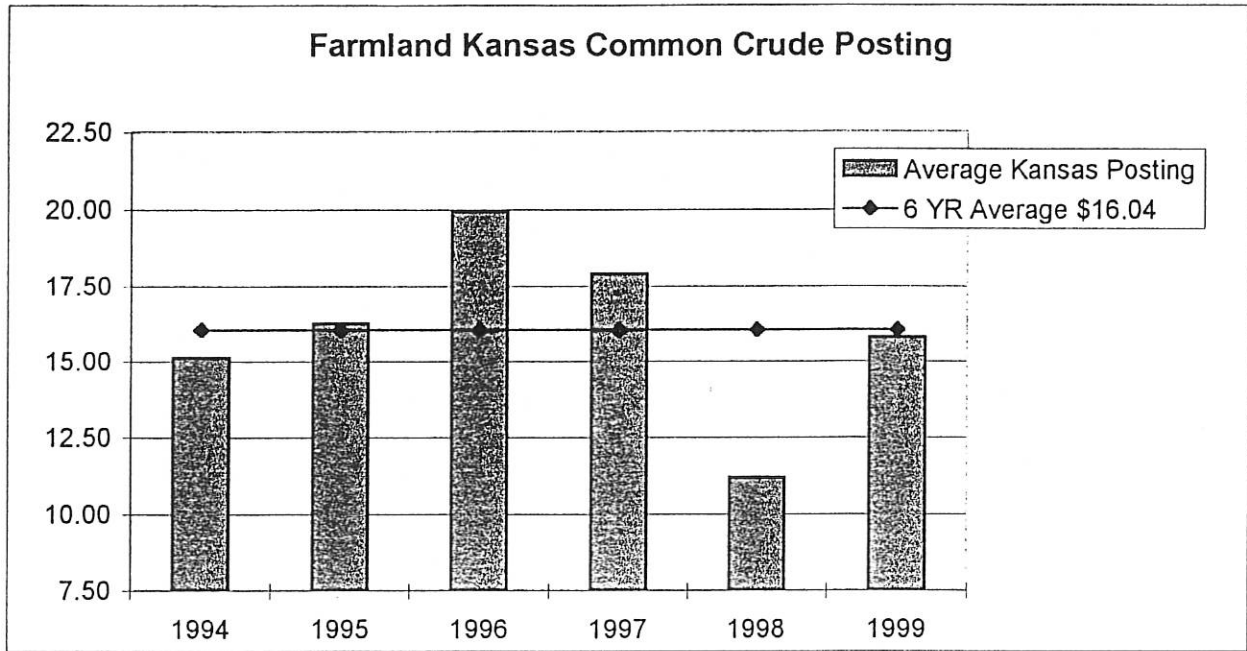
By Qun Tian, USA TODAY

At the same time, the Arab oil-producing countries have stuck with their supply controls that keep about 4 million barrels of oil off the market each day.

But none of this is likely to hold for long. Warmer weather will cut demand for heating oil, and OPEC's supply controls have always disintegrated in the past.

More importantly, even with today's high prices, fuel costs are low by historical standards, thanks to the long-term, steady decline in fuel costs. A barrel of oil today costs about half what it did in the early 1980s, once overall inflation is taken into account.

That healthy trend is largely the result of advances in technology that produce ever-greater supplies of oil at lower costs. That, not lots of hand wringing out of Washington, has been the consumer's best friend.



Farmland Kansas Common Crude Posting

| Month | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|--------|-------|-------|-------|-------|-------|-------|
| Jan. | 12.83 | 15.90 | 16.84 | 22.98 | 13.81 | 9.10 |
| Feb. | 12.60 | 16.65 | 16.71 | 19.96 | 13.13 | 8.54 |
| March | 12.50 | 16.37 | 19.09 | 18.46 | 12.02 | 11.29 |
| April | 14.23 | 17.68 | 21.27 | 17.29 | 12.38 | 13.86 |
| May | 16.10 | 17.44 | 19.02 | 18.26 | 11.77 | 14.43 |
| June | 17.29 | 16.24 | 18.33 | 16.43 | 10.30 | 14.55 |
| July | 17.80 | 15.02 | 19.21 | 16.77 | 10.74 | 16.70 |
| August | 16.27 | 15.82 | 19.85 | 16.98 | 10.13 | 17.99 |
| Sept. | 15.35 | 16.05 | 21.75 | 16.88 | 11.63 | 20.19 |
| Oct. | 15.61 | 15.19 | 22.85 | 18.43 | 11.12 | 19.16 |
| Nov. | 15.94 | 15.77 | 21.48 | 17.23 | 9.59 | 21.49 |
| Dec. | 14.98 | 17.00 | 22.88 | 15.41 | 7.85 | 22.47 |

| Yearly Average | 15.13 | 16.26 | 19.94 | 17.92 | 11.21 | 15.81 |
|------------------------------|-------|-------|-------|-------|-------|-------|
| Value crude oil/gal gasoline | 34.4¢ | 36.9¢ | 45.3¢ | 40.7¢ | 25.4¢ | 35.9¢ |
| Motor fuel tax/gal gasoline | 38.4¢ | 38.4¢ | 38.4¢ | 38.4¢ | 38.4¢ | 38.4¢ |
| Motor fuel tax/gal diesel | 46.4¢ | 46.4¢ | 46.4¢ | 46.4¢ | 46.4¢ | 46.4¢ |

*The amount of tax placed on a gallon of diesel fuel has exceeded the value of the crude oil in it in all of the last six years, and in four of the last six years on gasoline.