

VALERO ENERGY CORP/TX

Form 10-Q

May 07, 2009

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**For the quarterly period ended March 31, 2009**

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-13175

**VALERO ENERGY CORPORATION**  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

74-1828067  
(I.R.S. Employer  
Identification No.)

One Valero Way  
San Antonio, Texas  
(Address of principal executive offices)

78249

(Zip Code)

(210) 345-2000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of shares of the registrant's only class of common stock, \$0.01 par value, outstanding as of April 30, 2009 was 516,398,749.

**VALERO ENERGY CORPORATION AND SUBSIDIARIES  
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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(Millions of Dollars, Except Par Value)

	<b>March 31, 2009 (Unaudited)</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
Current assets:		
Cash and temporary cash investments	\$ 1,715	\$ 940
Restricted cash	139	131
Receivables, net	3,156	2,897
Inventories	4,669	4,637
Income taxes receivable	86	197
Deferred income taxes	78	98
Prepaid expenses and other	625	550
 Total current assets	 10,468	 9,450
Property, plant and equipment, at cost	28,644	28,103
Accumulated depreciation	(5,112)	(4,890)
 Property, plant and equipment, net	 23,532	 23,213
Intangible assets, net	213	224
Deferred charges and other assets, net	1,563	1,530
 Total assets	 \$ 35,776	 \$ 34,417
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Current portion of debt and capital lease obligations	\$ 312	\$ 312
Accounts payable	4,539	4,446
Accrued expenses	378	374
Taxes other than income taxes	501	592
Income taxes payable	2	
Deferred income taxes	505	485
 Total current liabilities	 6,237	 6,209
Debt and capital lease obligations, less current portion	7,264	6,264
Deferred income taxes	4,289	4,163
Other long-term liabilities	2,183	2,161

Commitments and contingencies

Stockholders' equity:

Common stock, \$0.01 par value; 1,200,000,000 shares authorized; 627,501,593 and 627,501,593 shares issued	6	6
Additional paid-in capital	7,194	7,190
Treasury stock, at cost; 111,145,049 and 111,290,436 common shares	(6,875)	(6,884)
Retained earnings	15,715	15,484
Accumulated other comprehensive loss	(237)	(176)
 Total stockholders' equity	 15,803	 15,620
 Total liabilities and stockholders' equity	 \$ 35,776	 \$ 34,417

See Condensed Notes to Consolidated Financial Statements.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(Millions of Dollars, Except per Share Amounts)  
(Unaudited)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2009</b>	<b>2008</b>
Operating revenues (1)	\$ 13,824	\$ 27,945
Costs and expenses:		
Cost of sales	11,628	25,669
Refining operating expenses	997	1,114
Retail selling expenses	169	188
General and administrative expenses	145	135
Depreciation and amortization expense	378	367
Total costs and expenses	13,317	27,473
Operating income	507	472
Other income (expense), net	(1)	20
Interest and debt expense:		
Incurred	(119)	(116)
Capitalized	40	19
Income before income tax expense	427	395
Income tax expense	118	134
Net income	\$ 309	\$ 261
Earnings per common share	\$ 0.60	\$ 0.49
Weighted-average common shares outstanding (in millions)	514	532
Earnings per common share assuming dilution	\$ 0.59	\$ 0.48
Weighted-average common shares outstanding assuming dilution (in millions)	519	541
Dividends per common share	\$ 0.15	\$ 0.12
Supplemental information:		
(1) Includes excise taxes on sales by our U.S. retail system	\$ 204	\$ 194

See Condensed Notes to Consolidated Financial Statements.



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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Millions of Dollars)  
(Unaudited)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 309	\$ 261
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	378	367
Stock-based compensation expense	12	12
Deferred income tax expense	169	8
Changes in current assets and current liabilities	(96)	(11)
Changes in deferred charges and credits and other operating activities, net	9	(9)
Net cash provided by operating activities	781	628
<b>Cash flows from investing activities:</b>		
Capital expenditures	(735)	(537)
Deferred turnaround and catalyst costs	(167)	(103)
Advance payments related to purchase of certain VeraSun Energy Corporation facilities	(13)	
Contingent payment in connection with acquisition		(25)
Minor acquisition		(57)
Other investing activities, net	6	6
Net cash used in investing activities	(909)	(716)
<b>Cash flows from financing activities:</b>		
Non-bank debt:		
Borrowings	998	
Repayments		(374)
Accounts receivable sales program:		
Proceeds from sale of receivables	100	
Repayments	(100)	
Purchase of common stock for treasury		(518)
Issuance of common stock in connection with employee benefit plans	1	7
Benefit from tax deduction in excess of recognized stock-based compensation cost	1	8
Common stock dividends	(77)	(64)
Debt issuance costs	(7)	
Other financing activities	(2)	
Net cash provided by (used in) financing activities	914	(941)



Effect of foreign exchange rate changes on cash	(11)	(4)
<b>Net increase (decrease) in cash and temporary cash investments</b>	<b>775</b>	<b>(1,033)</b>
<b>Cash and temporary cash investments at beginning of period</b>	<b>940</b>	<b>2,464</b>
<b>Cash and temporary cash investments at end of period</b>	<b>\$ 1,715</b>	<b>\$ 1,431</b>

See Condensed Notes to Consolidated Financial Statements.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(Millions of Dollars)  
(Unaudited)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2009</b>	<b>2008</b>
Net income	\$ 309	\$ 261
Other comprehensive income (loss):		
Foreign currency translation adjustment	(81)	(77)
Net gain (loss) on derivative instruments designated and qualifying as cash flow hedges:		
Net gain (loss) arising during the period, net of income tax (expense) benefit of \$(32) and \$27	60	(49)
Net gain reclassified into income, net of income tax expense of \$21 and \$8	(40)	(15)
Net gain (loss) on cash flow hedges	20	(64)
Other comprehensive loss	(61)	(141)
Comprehensive income	\$ 248	\$ 120

See Condensed Notes to Consolidated Financial Statements.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES  
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. BASIS OF PRESENTATION, PRINCIPLES OF CONSOLIDATION, AND SIGNIFICANT ACCOUNTING POLICIES**

As used in this report, the terms Valero, we, us, or our may refer to Valero Energy Corporation, one or more of its consolidated subsidiaries, or all of them taken as a whole.

These unaudited consolidated financial statements include the accounts of Valero and subsidiaries in which Valero has a controlling interest. Intercompany balances and transactions have been eliminated in consolidation. Investments in significant non-controlled entities are accounted for using the equity method.

These unaudited consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934. Accordingly, they do not include all of the information and notes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature unless disclosed otherwise. Financial information for the three months ended March 31, 2009 and 2008 included in these Condensed Notes to Consolidated Financial Statements is derived from our unaudited consolidated financial statements. Operating results for the three months ended March 31, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

The consolidated balance sheet as of December 31, 2008 has been derived from the audited financial statements as of that date. For further information, refer to the consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2008.

***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires our management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. On an ongoing basis, management reviews its estimates based on currently available information. Changes in facts and circumstances may result in revised estimates.

**2. ACCOUNTING PRONOUNCEMENTS**

***FSP No. FAS 157-2***

In February 2008, the Financial Accounting Standards Board (FASB) issued Staff Position No. FAS 157-2 (FSP No. 157-2), which delayed the effective date of Statement No. 157, Fair Value Measurements, for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008. The exceptions apply to the following: nonfinancial assets and nonfinancial liabilities measured at fair value in a business combination; impaired property, plant and equipment; goodwill; and the initial recognition of the fair value of asset retirement obligations and restructuring costs. The implementation of Statement No. 157 for these assets and liabilities effective January 1, 2009 did not affect our financial position or results of operations but did result in additional disclosures, which are provided in Note 9.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES  
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***FASB Statement No. 141 (revised 2007)***

In December 2007, the FASB issued Statement No. 141 (revised 2007), *Business Combinations* (Statement No. 141(R)). This statement improves the financial reporting of business combinations and clarifies the accounting for these transactions. The provisions of Statement No. 141(R) are to be applied prospectively to business combinations with acquisition dates on or after the beginning of an entity's fiscal year that begins on or after December 15, 2008, with early adoption prohibited. Due to its application to future acquisitions, the adoption of Statement No. 141(R) effective January 1, 2009 has not had any immediate effect on our financial position or results of operations.

***FASB Statement No. 160***

In December 2007, the FASB issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment of ARB No. 51. Statement No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. This statement provides guidance for the accounting and reporting of noncontrolling interests, changes in controlling interests, and the deconsolidation of subsidiaries. In addition, Statement No. 160 amends FASB Statement No. 128, *Earnings per Share*, to specify the computation, presentation, and disclosure requirements for earnings per share if an entity has one or more noncontrolling interests. The adoption of Statement No. 160 effective January 1, 2009 has not affected our financial position or results of operations.

***FASB Statement No. 161***

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. Statement No. 161 establishes, among other things, the disclosure requirements for derivative instruments and for hedging activities. This statement requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about contingent features related to credit risk in derivative agreements. Statement No. 161 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2008. The adoption of Statement No. 161 effective January 1, 2009 did not affect our financial position or results of operations but did result in additional disclosures, which are provided in Note 10.

***FSP No. EITF 03-6-1***

In June 2008, the FASB issued Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP No. EITF 03-6-1). FSP No. EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method described in Statement No. 128. FSP No. EITF 03-6-1 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008; early adoption is not permitted. Shares of restricted stock granted under certain of our stock-based compensation plans represent participating securities covered by FSP No. EITF 03-6-1. However, the adoption of FSP No. EITF 03-6-1 effective January 1, 2009 did not affect our basic earnings per common share for the three months ended March 31, 2009 and 2008, the calculation of which is provided in Note 7.

***EITF Issue No. 08-6***

In November 2008, the FASB ratified its consensus on EITF Issue No. 08-6, *Equity Method Investment Accounting Considerations* (EITF No. 08-6). EITF No. 08-6 applies to all investments accounted for

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

under the equity method and provides guidance regarding (i) initial measurement of an equity investment, (ii) recognition of other-than-temporary impairment of an equity method investment, including any impairment charge taken by the investee, and (iii) accounting for a change in ownership level or degree of influence on an investee. The consensus is effective for fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years. EITF No. 08-6 is to be applied prospectively and earlier application is not permitted. Due to its application to future equity method investments, the adoption of EITF No. 08-6 effective January 1, 2009 has not had any immediate effect on our financial position or results of operations.

***FSP No. FAS 132(R)-1***

In December 2008, the FASB issued Staff Position No. FAS 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP No. FAS 132(R)-1). FSP No. FAS 132(R)-1 amends FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, to provide guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. The additional requirements of FSP No. FAS 132(R)-1 are designed to enhance disclosures regarding (i) investment policies and strategies, (ii) categories of plan assets, (iii) fair value measurements of plan assets, and (iv) significant concentrations of risk. FSP No. FAS 132(R)-1 is effective for fiscal years ending after December 15, 2009, with earlier application permitted. Since FSP No. FAS 132(R)-1 only affects disclosure requirements, the adoption of FSP No. FAS 132(R)-1 will not affect our financial position or results of operations.

***FSP No. FAS 141(R)-1***

In April 2009, the FASB issued Staff Position No. FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (FSP No. FAS 141(R)-1). FSP No. FAS 141(R)-1 amends and clarifies FASB Statement No. 141(R) to address application issues raised related to (i) initial recognition and measurement, (ii) subsequent measurement and accounting, and (iii) disclosure of assets and liabilities arising from contingencies in a business combination. The provisions of FSP No. FAS 141(R)-1 are to be applied to contingent assets or contingent liabilities acquired in business combinations for which the acquisition date is on or after the beginning of an entity's fiscal year that begins on or after December 15, 2008. Due to its application to future acquisitions, the adoption of FSP No. FAS 141(R)-1 effective January 1, 2009 has not had any immediate effect on our financial position or results of operations.

***FSP No. FAS 107-1 and APB 28-1, FSP No. FAS 157-4, and FSP No. FAS 115-2 and FAS 124-2***

In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP No. FAS 107-1 and APB 28-1). FSP No. FAS 107-1 and APB 28-1 amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require a publicly traded company to include disclosures about the fair value of its financial instruments for interim reporting periods as well as in annual financial statements. FSP No. FAS 107-1 and APB 28-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The early adoption provision of FSP No. FAS 107-1 and APB 28-1 is available only if an entity also elects to apply the early adoption provisions of FASB Staff Position No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP No. FAS 157-4), and FASB Staff Position No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP No. FAS 115-2 and FAS 124-2). We adopted these three FASB Staff Positions in the first quarter of 2009, none of which has affected our financial

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

position or results of operations. However, the adoption of FSP No. FAS 107-1 and APB 28-1 resulted in additional interim disclosures discussed below.

Our financial instruments include cash and temporary cash investments, restricted cash, receivables, payables, debt, capital lease obligations, commodity derivative contracts, and foreign currency derivative contracts. The estimated fair values of these financial instruments approximate their carrying amounts as reflected in the consolidated balance sheets, except for certain debt as discussed in Note 5. The fair values of our debt, commodity derivative contracts, and foreign currency derivative contracts were estimated primarily based on quoted market prices.

**3. ACQUISITIONS**

On February 6, 2009, we entered into a binding agreement with VeraSun Energy Corporation (VeraSun) pursuant to which we offered to purchase from VeraSun five existing ethanol plants and a site currently under development. The existing ethanol plants included in the agreement are located in Charles City, Fort Dodge, and Hartley, Iowa; Aurora, South Dakota; and Welcome, Minnesota, and the site under development is located in Reynolds, Indiana. VeraSun's primary business was the production and marketing of ethanol and its co-products, including distillers grains. VeraSun previously filed for relief under Chapter 11 of the U.S. Bankruptcy Code.

On March 18, 2009, the bankruptcy court accepted our bid to purchase the six facilities mentioned above and also approved our purchase of two additional ethanol plants located in Albion, Nebraska, and Albert City, Iowa (collectively, the VeraSun Acquisition). On April 1, 2009, we completed the purchase of the ethanol facilities in our original bid for a purchase price of \$350 million, plus approximately \$75 million primarily for inventory and certain other working capital. On April 9, 2009, we completed the purchase of the plant in Albert City for a purchase price of \$72 million. We expect to complete the purchase of the plant in Albion for a purchase price of \$55 million later in the second quarter of 2009.

The VeraSun Acquisition expands our clean motor fuels business. The purchase price was funded with part of the proceeds from a \$1 billion issuance of notes in March 2009, which is discussed in Note 5. A determination of the fair values of the assets acquired and liabilities assumed is pending the completion of independent appraisals and other evaluations.

**4. INVENTORIES**

Inventories consisted of the following (in millions):

	<b>March 31,</b>	<b>December</b>
	<b>2009</b>	<b>31,</b>
		<b>2008</b>
Refinery feedstocks	\$ 2,186	\$ 2,140
Refined products and blendstocks	2,211	2,224
Convenience store merchandise	86	90
Materials and supplies	186	183
 Inventories	 \$ 4,669	 \$ 4,637

As of March 31, 2009 and December 31, 2008, the replacement cost (market value) of LIFO inventories exceeded their LIFO carrying amounts by approximately \$1.1 billion and \$686 million, respectively.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. DEBT*****Non-Bank Debt***

In March 2009, we issued \$750 million of 9.375% notes due March 15, 2019 and \$250 million of 10.5% notes due March 15, 2039. Proceeds from the issuance of these notes totaled approximately \$998 million, before deducting underwriting discounts of \$7 million.

On April 1, 2009, we made scheduled debt repayments of \$200 million related to our 3.5% notes and \$9 million related to our 5.125% Series 1997D industrial revenue bonds.

On February 1, 2008, we redeemed our 9.50% senior notes for \$367 million, or 104.75% of stated value. These notes had a carrying amount of \$381 million on the date of redemption, resulting in a gain of \$14 million that was included in other income (expense), net in the consolidated statement of income. In addition, in March 2008, we made a scheduled debt repayment of \$7 million related to certain of our other debt.

***Bank Credit Facilities***

During the three months ended March 31, 2009, we had no borrowings or repayments under our revolving bank credit facilities. As of March 31, 2009, we had no borrowings outstanding under our committed revolving credit facilities or our short-term uncommitted bank credit facilities.

As of March 31, 2009, we had \$218 million of letters of credit outstanding under our uncommitted short-term bank credit facilities and \$224 million of letters of credit outstanding under our three U.S. committed revolving credit facilities. Under our Canadian committed revolving credit facility, we had Cdn. \$19 million of letters of credit outstanding as of March 31, 2009.

***Accounts Receivable Sales Facility***

We have an accounts receivable sales facility with a group of third-party entities and financial institutions to sell on a revolving basis up to \$1 billion of eligible trade receivables, which matures in June 2009. As of December 31, 2008, the amount of eligible receivables sold to the third-party entities and financial institutions was \$100 million, which was repaid in February 2009. In March 2009, we sold \$100 million of eligible receivables to the third-party entities and financial institutions, which remained outstanding as of March 31, 2009. In April 2009, we sold an additional \$400 million of eligible receivables under this program.

***Other Disclosures***

The estimated fair value of our debt, including current portion, was as follows (in millions):

	<b>March 31, 2009</b>	<b>December 31, 2008</b>
Carrying amount	\$ 7,537	\$ 6,537
Fair value	7,654	6,462

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES  
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**6. STOCKHOLDERS EQUITY**

***Treasury Stock***

No significant purchases of our common stock were made during the three months ended March 31, 2009. During the three months ended March 31, 2008, we purchased 8.8 million shares of our common stock at a cost of \$518 million in connection with the administration of our employee benefit plans and common stock purchase programs authorized by our board of directors. During the three months ended March 31, 2009, we issued 0.2 million shares from treasury at an average cost of \$63.49 per share, and for the three months ended March 31, 2008, we issued 0.6 million shares from treasury at an average cost of \$67.37 per share, for our employee benefit plans.

***Common Stock Dividends***

On April 30, 2009, our board of directors declared a regular quarterly cash dividend of \$0.15 per common share payable on June 17, 2009 to holders of record at the close of business on May 27, 2009.



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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**7. EARNINGS PER COMMON SHARE**

Earnings per common share amounts were computed as follows (dollars and shares in millions, except per share amounts):

	<b>Three Months Ended March 31,</b>			
	<b>2009</b>		<b>2008</b>	
	<b>Restricted Stock</b>	<b>Common Stock</b>	<b>Restricted Stock</b>	<b>Common Stock</b>
Earnings per common share:				
Net income		\$ 309		\$ 261
Less dividends paid:				
Common stock		77		64
Nonvested restricted stock				
Undistributed earnings		\$ 232		\$ 197
Weighted-average common shares outstanding	2	514	1	532
Earnings per common share:				
Distributed earnings	\$ 0.15	\$ 0.15	\$ 0.12	\$ 0.12
Undistributed earnings	0.45	0.45	0.37	0.37
Total earnings per common share	\$ 0.60	\$ 0.60	\$ 0.49	\$ 0.49
Earnings per common share assuming dilution:				
Net income		\$ 309		\$ 261
Weighted-average common shares outstanding		514		532
Effect of dilutive securities:				
Stock options		4		8
Performance awards and other benefit plans		1		1
Weighted-average common shares outstanding assuming dilution		519		541
Earnings per common share assuming dilution		\$ 0.59		\$ 0.48

Approximately 10 million and 2 million outstanding stock options were not included in the computation of dilutive securities for the three months ended March 31, 2009 and 2008, respectively, because the options' exercise prices were greater than the average market price of the common shares during the reporting period, and therefore the effect of including such options would be anti-dilutive.



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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. STATEMENTS OF CASH FLOWS**

In order to determine net cash provided by operating activities, net income is adjusted by, among other things, changes in current assets and current liabilities as follows (in millions):

	<b>Three Months Ended March 31,</b>	
	<b>2009</b>	<b>2008</b>
Decrease (increase) in current assets:		
Restricted cash	\$ (8)	\$ (10)
Receivables, net	(245)	1,663
Inventories	(50)	(469)
Income taxes receivable	117	
Prepaid expenses and other	(90)	47
Increase (decrease) in current liabilities:		
Accounts payable	231	(771)
Accrued expenses	35	(82)
Taxes other than income taxes	(86)	(93)
Income taxes payable		(296)
Changes in current assets and current liabilities	\$ (96)	\$ (11)

The above changes in current assets and current liabilities differ from changes between amounts reflected in the applicable consolidated balance sheets for the respective periods for the following reasons:

the amounts shown above exclude changes in cash and temporary cash investments, deferred income taxes, and current portion of debt and capital lease obligations, as well as the effect of certain noncash investing and financing activities discussed below;

previously accrued capital expenditures, deferred turnaround and catalyst costs, and contingent earn-out payments are reflected in investing activities in the consolidated statements of cash flows;

amounts accrued for common stock purchases in the open market that are not settled as of the balance sheet date are reflected in financing activities in the consolidated statements of cash flows when the purchases are settled and paid;

changes in assets held for sale and liabilities related to assets held for sale pertaining to the operations of the Krotz Springs Refinery prior to its sale to Alon Refining Krotz Springs, Inc. (Alon), a subsidiary of Alon USA Energy, Inc., in July 2008 are reflected in the line items to which the changes relate in the table above; and certain differences between consolidated balance sheet changes and consolidated statement of cash flow changes reflected above result from translating foreign currency denominated amounts at different exchange rates.

There were no significant noncash investing or financing activities for the three months ended March 31, 2009 and 2008.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Cash flows related to interest and income taxes were as follows (in millions):

	<b>Three Months Ended March</b>	
	<b>2009</b>	<b>2008</b>
Interest paid in excess of (less than) amount capitalized	\$ (19)	\$ 16
Income taxes paid (net of tax refunds received)	(168)	414

**9. FAIR VALUE MEASUREMENTS**

Statement No. 157 establishes a fair value hierarchy (Level 1, Level 2, or Level 3) based on the quality of inputs used to measure fair value. Pursuant to the provisions of Statement No. 157, fair values determined by Level 1 inputs utilize quoted prices in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs are based on quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. We use appropriate valuation techniques based on the available inputs to measure the fair values of our applicable assets and liabilities. When available, we measure fair value using Level 1 inputs because they generally provide the most reliable evidence of fair value.

The table below presents information (dollars in millions) about our financial assets and liabilities measured and recorded at fair value on a recurring basis and indicates the fair value hierarchy of the inputs utilized by us to determine the fair values as of March 31, 2009 and December 31, 2008.

	<b>Fair Value Measurements Using</b>			
	<b>Quoted Prices in Active Markets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Total as of March 31, 2009</b>
<b>Assets:</b>				
Commodity derivative contracts	\$ 85	\$ 784	\$	\$ 869
Nonqualified benefit plans	89			89
Alon earn-out agreement			24	24
<b>Liabilities:</b>				
Commodity derivative contracts		14		14
Certain nonqualified benefit plans	24			24

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	Fair Value Measurements Using			Total as of December 31, 2008
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets:</b>				
Commodity derivative contracts	\$ 40	\$ 610	\$	\$ 650
Nonqualified benefit plans	98			98
Alon earn-out agreement			13	13
<b>Liabilities:</b>				
Commodity derivative contracts		7		7
Certain nonqualified benefit plans	26			26

The valuation methods used to measure our financial instruments at fair value are as follows:

Commodity derivative contracts, consisting primarily of exchange-traded futures and swaps, are measured at fair value using the market approach pursuant to the provisions of Statement No. 157. Exchange-traded futures are valued based on quoted prices from the exchange and are categorized in Level 1 of the fair value hierarchy. Swaps are priced using third-party broker quotes, industry pricing services, and exchange-traded curves, with appropriate consideration of counterparty credit risk, but since they have contractual terms that are not identical to exchange-traded futures instruments with a comparable market price, these financial instruments are categorized in Level 2 of the fair value hierarchy.

Nonqualified benefit plan assets and certain nonqualified benefit plan liabilities are measured at fair value using a market approach based on quotations from national securities exchanges and are categorized in Level 1 of the fair value hierarchy.

The Alon earn-out agreement, which we received as partial consideration for the sale of our Krotz Springs Refinery in July 2008, is measured at fair value using a discounted cash flow model and is categorized in Level 3 of the fair value hierarchy. Significant inputs to the model include expected payments and discount rates that consider the effects of both credit risk and the time value of money.

A \$210 million obligation to pay cash collateral to brokers under master netting arrangements is netted against the fair value of the commodity derivatives reflected in Level 1. Certain of our commodity derivative contracts under master netting arrangements include both asset and liability positions. Under the guidance of FASB Staff Position No. FIN 39-1, Amendment of FASB Interpretation No. 39, we have elected to offset the fair value amounts recognized for multiple derivative instruments executed with the same counterparty, including any related cash collateral asset or obligation.

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The following is a reconciliation of the beginning and ending balances (in millions) for fair value measurements developed using significant unobservable inputs for the three months ended March 31, 2009. We did not have any fair value measurements using significant unobservable inputs for the three months ended March 31, 2008.

Balance as of December 31, 2008	\$ 13
Net unrealized gains included in earnings	11
Transfers in and/or out of Level 3	
Balance as of March 31, 2009	\$ 24

Unrealized gains for the three months ended March 31, 2009, which are reported in other income (expense), net in the consolidated statement of income, relate to the Alon earn-out agreement that was still held at the reporting date. These unrealized gains were offset by the recognition in other income (expense), net of losses on derivative instruments entered into to hedge the risk of changes in the fair value of the Alon earn-out agreement. These derivative instruments are included in the commodity derivative contracts amounts reflected in the fair value table above. The table below presents information (dollars in millions) about our nonfinancial liabilities measured and recorded at fair value on a nonrecurring basis that arose on or after January 1, 2009 (the date of adoption of FSP No. FAS 157-2), and indicates the fair value hierarchy of the inputs utilized by us to determine the fair values as of March 31, 2009.

Fair Value Measurements Using			
Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total as of March 31, 2009

**Liabilities:**

Asset retirement obligations	\$	\$	\$ 6	\$ 6
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Asset retirement obligations in the table above are calculated based on the present value of estimated removal and other closure costs using our internal risk-free rate of return.

**10. PRICE RISK MANAGEMENT ACTIVITIES**

We enter into derivative instruments to manage our exposure to commodity price risk, interest rate risk, and foreign currency risk, and to hedge price risk on other contractual derivatives that we have entered into. In addition, we use derivative instruments for trading purposes based on our fundamental and technical analysis of market conditions. All derivative instruments are recorded on our balance sheet as either assets or liabilities measured at their fair values. When we enter into a derivative instrument, it is designated as a fair value hedge, a cash flow hedge, an economic hedge, or a trading activity. The gain or loss on a derivative instrument designated and qualifying as a fair value hedge, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized currently in income in the same period. The effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedge is initially reported as a component of other comprehensive income and is then recorded in income in the period or periods during which the hedged forecasted transaction affects

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**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

income. The ineffective portion of the gain or loss on the cash flow derivative instrument, if any, is recognized in income as incurred. For our economic hedging relationships (hedges not designated as fair value or cash flow hedges) and for derivative instruments entered into by us for trading purposes, the derivative instrument is recorded at fair value and changes in the fair value of the derivative instrument are recognized currently in income.

**Commodity Price Risk**

We are exposed to market risks related to the volatility of crude oil and refined product prices, as well as volatility in the price of natural gas used in our refining operations. To reduce the impact of this price volatility on our results of operations and cash flows, we use derivative commodity instruments, including swaps, futures, and options, to manage our exposure to commodity price risks. For such risk management purposes, we use fair value hedges, cash flow hedges, and economic hedges.

In addition to the use of derivative instruments to manage commodity price risk, we also enter into certain derivative commodity instruments for trading purposes. Our objectives for entering into each of these types of derivative instruments and the level of activity of each as of March 31, 2009 are described below.

**Fair Value Hedges**

Fair value hedges are used to hedge certain recognized refining inventories and unrecognized firm commitments to purchase inventories. The level of activity for our fair value hedges is based on the level of our operating inventories, and normally represents the amount by which our inventories differ from our previous year-end LIFO inventory levels.

As of March 31, 2009, we had the following outstanding derivative commodity instruments that were entered into to hedge crude oil and refined product inventories. The information presents the volume of outstanding contracts by type of instrument and year of maturity (volumes in thousands of barrels).

<b>Derivative Instrument / Maturity</b>	<b>Contract Volumes</b>
Futures short (2009)	7,267

**Cash Flow Hedges**

Cash flow hedges are used to hedge certain forecasted feedstock and product purchases, refined product sales, and natural gas purchases. The purpose of our cash flow hedges is to lock in the price of forecasted feedstock or natural gas purchases or refined product sales at existing market prices that are deemed favorable by management.

As of March 31, 2009, we had the following outstanding derivative commodity instruments that were entered into to hedge forecasted purchases or sales of crude oil and refined products. The information presents the volume of outstanding contracts by type of instrument and year of maturity (volumes in thousands of barrels).



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<b>Derivative Instrument / Maturity</b>	<b>Contract Volumes</b>
Swaps long:	
2009	20,802
2010	15,900
Swaps short:	
2009	20,802
2010	15,900
Futures long (2009)	1,238

**Economic Hedges**

Economic hedges are hedges not designated as fair value or cash flow hedges that are used to (i) manage price volatility in certain refinery feedstock and refined product inventories, (ii) manage price volatility in certain forecasted feedstock and product purchases, refined product sales, and natural gas purchases; and (iii) manage price volatility in the referenced product margins associated with the Alon earn-out agreement, which is a separate contractual derivative that we entered into with the sale of our Krotz Springs Refinery, as further discussed in Note 9. Our objective in entering into economic hedges is consistent with the objectives discussed above for fair value hedges and cash flow hedges. However, the economic hedges are not designated as a fair value hedge or a cash flow hedge for accounting purposes, usually due to the difficulty of establishing the required documentation at the date that the derivative instrument is entered into. As of March 31, 2009, we had the following outstanding derivative commodity instruments that were entered into as economic hedges. The information presents the volume of outstanding contracts by type of instrument and year of maturity (volumes in thousands of barrels).

<b>Derivative Instrument / Maturity</b>	<b>Contract Volumes</b>
Swaps long:	
2009	46,937
2010	27,764
2011	3,900
Swaps short:	
2009	38,153
2010	27,918
2011	3,900
Futures long:	
2009	300,779
2010	27,086
Futures short:	
2009	297,998
2010	27,416
Options long (2009)	13

**Trading Activities**

These represent derivative commodity instruments held or issued for trading purposes. Our objective in entering into derivative commodity instruments for trading purposes is to take advantage of existing market conditions related to crude oil and refined products that management perceives as opportunities to benefit our results of operations and cash flows, but for which there are no related physical transactions. As of March 31, 2009, we had the following

outstanding derivative commodity instruments that were entered into for trading purposes. The information presents the volume of outstanding contracts by type

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of instrument and year of maturity (volumes represent thousands of barrels, except those identified as natural gas contracts that are presented in billions of British thermal units).

<b>Derivative Instrument / Maturity</b>	<b>Contract Volumes</b>
Swaps long:	
2009	14,482
2010	14,610
2011	1,950
Swaps short:	
2009	13,905
2010	9,609
2011	1,950
Futures long:	
2009	21,809
2010	1,411
2009 (natural gas)	100
Futures short:	
2009	21,784
2010	1,411
2009 (natural gas)	100

**Interest Rate Risk**

Our primary market risk exposure for changes in interest rates relates to our debt obligations. We manage our exposure to changing interest rates through the use of a combination of fixed-rate and floating-rate debt. In addition, we have at times used interest rate swap agreements to manage our fixed to floating interest rate position by converting certain fixed-rate debt to floating-rate debt. These interest rate swap agreements are generally accounted for as fair value hedges. However, we have not had any outstanding interest rate swap agreements since 2006.

**Foreign Currency Risk**

We are exposed to exchange rate fluctuations on transactions related to our Canadian operations. To manage our exposure to these exchange rate fluctuations, we use foreign currency exchange and purchase contracts. These contracts are not designated as hedging instruments for accounting purposes, and therefore they are classified as economic hedges. As of March 31, 2009, we had commitments to purchase \$106 million of U.S. dollars. These commitments matured on or before April 24, 2009, resulting in a \$3 million loss in the second quarter of 2009.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
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***Fair Values of Derivative Instruments***

The following tables provide information about the fair values of our derivative instruments as of March 31, 2009 (in millions) and the line items in the balance sheet in which the fair values are reflected. See Note 9 for additional information related to the fair values of our derivative instruments. As indicated in Note 9, we net fair value amounts recognized for multiple derivative instruments executed with the same counterparty under master netting arrangements. The table below, however, is presented on a gross asset and gross liability basis as required by FASB Statement No. 161, which results in the reflection of certain assets in liability accounts and certain liabilities in asset accounts.

	<b>Asset Derivatives</b>		<b>Liability Derivatives</b>	
	<b>Balance Sheet</b>		<b>Balance Sheet</b>	
	<b>Location</b>	<b>Fair Value</b>	<b>Location</b>	<b>Fair Value</b>
<b>Derivatives designated as</b>				
<b><u>hedging instruments</u></b>				
Commodity contracts:				
Futures	Receivables, net	\$ 65	Receivables, net	\$ 80
Swaps	Receivables, net	539	Receivables, net	454
Swaps	Prepaid expenses and other current assets	3,044	Prepaid expenses and other current assets	2,789
Swaps	Accrued expenses	1	Accrued expenses	3
Total derivatives designated as hedging instruments		\$ 3,649	\$ 3,326	
<b>Derivatives not designated as</b>				
<b><u>hedging instruments</u></b>				
Commodity contracts:				
Futures	Receivables, net	\$ 2,962	Receivables, net	\$ 2,652
Swaps	Receivables, net	898	Receivables, net	740
Swaps	Prepaid expenses and other current assets	2,031	Prepaid expenses and other current assets	1,746
Swaps	Accrued expenses	61	Accrued expenses	72
Alon earn-out agreement	Receivables, net	24	Accrued expenses	
Foreign currency contracts	Receivables, net		Accounts payable	
Total derivatives not designated as hedging instruments		\$ 5,976	\$ 5,210	
Total derivatives		\$ 9,625	\$ 8,536	

***Market and Counterparty Risk***

Our price risk management activities involve the receipt or payment of fixed price commitments into the future. These

transactions give rise to market risk, the risk that future changes in market conditions may make an instrument less valuable. We closely monitor and manage our exposure to market risk on a daily basis in accordance with policies approved by our board of directors. Market risks are monitored by a risk control group to ensure compliance with our stated risk management policy. Concentrations of customers in the refining industry may impact our overall exposure to counterparty risk, in that these

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customers may be similarly affected by changes in economic or other conditions. In addition, financial services companies are the counterparties in certain of our price risk management activities, and such financial services companies may be adversely affected by periods of uncertainty and illiquidity in the credit and capital markets.

As of March 31, 2009, we had net receivables related to derivative instruments of \$59 million from counterparties in the refining industry and \$481 million from counterparties in the financial services industry. These amounts represent the aggregate amount payable to us by companies in those industries, reduced by amounts payable by us to those companies under master netting arrangements that allow for the setoff of amounts receivable from and payable to the same party. We do not require any collateral or other security to support derivative instruments that we enter into. We also do not have any derivative instruments that require us to maintain a minimum investment-grade credit rating.

***Effect of Derivative Instruments on Statements of Income and Other Comprehensive Income***

The following tables provide information about the gain or loss recognized in income and other comprehensive income on our derivative instruments for the three months ended March 31, 2009 (in millions), and the line items in the financial statements in which such gains and losses are reflected.

	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives	Location of Gain or (Loss) Recognized in Income on Hedged Item	Amount of Gain or (Loss) Recognized in Income on Hedged Item	Amount of Gain or (Loss) Recognized in Income for Ineffective Portion of Derivative (1)
Derivatives in Fair Value Hedging Relationships	Cost of sales	\$ (15)	Cost of sales	\$ 15	\$
Total		\$ (15)		\$ 15	\$

(1) For fair value hedges, no component of the derivative instruments' gains or losses was excluded from the assessment of hedge effectiveness. No amounts were recognized in income for hedged firm commitments that no longer qualify as fair value hedges.

	Amount of Gain or (Loss) Recognized in OCI on Derivatives	Location of Gain or (Loss) Reclassified from Accumulated OCI	Amount of Gain or (Loss) Reclassified from Accumulated OCI	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives
Derivatives in Cash Flow					

<b>Hedging Relationships</b>	<b>(Effective Portion)</b>	<b>into Income (Effective Portion)</b>	<b>into Income (Effective Portion)</b>	<b>(Ineffective Portion)</b>	<b>(Ineffective Portion) (1)</b>
Commodity contracts (2)	\$ 92	Cost of sales	\$ 61	Cost of sales	\$
Total	\$ 92		\$ 61		\$

- (1) No component of the derivative instruments gains or losses was excluded from the assessment of hedge effectiveness.
- (2) For the three months ended March 31, 2009, cash flow hedges primarily related to forward sales of distillates and associated forward purchases of crude oil, with \$189 million of cumulative after-tax gains on cash flow hedges remaining in accumulated other comprehensive income (loss) as of March 31, 2009. We expect that a significant amount of the deferred gains at March 31, 2009 will be reclassified into cost of sales over the next 12 months as a result of hedged transactions that are forecasted to occur. The amount ultimately realized in income, however, will differ as commodity prices change. For the three months ended March 31, 2009, there were no amounts reclassified from accumulated other comprehensive income (loss) into income as a result of the discontinuance of cash flow hedge accounting.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
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<b>Derivatives Designated as Economic Hedges and Other Derivative Instruments</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivatives</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivatives</b>
Commodity contracts	Cost of sales	\$ 96
Foreign currency contracts	Cost of sales	6
		102
Alon earn-out agreement	Other income (expense)	11
Alon earn-out hedge (commodity contracts)	Other income (expense)	(15)
		(4)
Total		\$ 98

<b>Derivatives Designated as Trading Activities</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivatives</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivatives</b>
Commodity contracts	Cost of sales	\$ 91
Total		\$ 91

**11. SEGMENT INFORMATION**

Segment information for our two reportable segments, refining and retail, was as follows (in millions):

	<b>Refining</b>	<b>Retail</b>	<b>Corporate</b>	<b>Total</b>
<b>Three months ended March 31, 2009:</b>				
Operating revenues from external customers	\$ 12,192	\$ 1,632	\$	\$ 13,824
Intersegment revenues	1,007			1,007
Operating income (loss)	607	56	(156)	507



**Three months ended****March 31, 2008:**

Operating revenues from external customers	25,430	2,515		27,945
Intersegment revenues	1,900			1,900
Operating income (loss)	568	50	(146)	472

Total assets by reportable segment were as follows (in millions):

	<b>March 31, 2009</b>	<b>December 31, 2008</b>
Refining	\$ 31,618	\$ 30,801
Retail	1,754	1,818
Corporate	2,404	1,798
Total consolidated assets	\$ 35,776	\$ 34,417

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**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**12. EMPLOYEE BENEFIT PLANS**

The components of net periodic benefit cost related to our defined benefit plans were as follows for the three months ended March 31, 2009 and 2008 (in millions):

	<b>Pension Plans</b>		<b>Other Postretirement Benefit Plans</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Components of net periodic benefit cost:				
Service cost	\$ 26	\$ 23	\$ 3	\$ 3
Interest cost	20	19	6	7
Expected return on plan assets	(27)	(26)		
Amortization of:				
Prior service cost (credit)		1	(4)	(2)
Net loss	3		2	1
Net periodic benefit cost	\$ 22	\$ 17	\$ 7	\$ 9

Our anticipated contributions to our qualified pension plans during 2009 have not changed from amounts previously disclosed in our consolidated financial statements for the year ended December 31, 2008. In January 2009, we contributed \$50 million to our main qualified pension plan. There were no contributions made during the three months ended March 31, 2008.

**13. COMMITMENTS AND CONTINGENCIES*****Contingent Earn-Out Agreements***

In January 2008, we made a previously accrued earn-out payment of \$25 million related to the acquisition of the St. Charles Refinery, which was the final payment under that agreement. As of March 31, 2009, we have no further commitments with respect to contingent earn-out agreements. However, see Note 9 for a discussion of a contingent receivable from Alon related to a three-year earn-out agreement received in July 2008 as partial consideration for the sale of our Krotz Springs Refinery.

***Insurance Recoveries***

During the first quarter of 2007, our McKee Refinery was shut down due to a fire originating in its propane deasphalting unit, resulting in business interruption losses for which we submitted claims to our insurance carriers under our insurance policies. We reached a settlement with the insurance carriers on our claims, resulting in pre-tax income of approximately \$100 million in the first quarter of 2008 that was recorded as a reduction to cost of sales.

***Tax Matters***

We are subject to extensive tax liabilities, including federal, state, and foreign income taxes and transactional taxes such as excise, sales/use, payroll, franchise, withholding, and ad valorem taxes. New tax laws and regulations and changes in existing tax laws and regulations are continuously being enacted or proposed that could result in increased expenditures for tax liabilities in the future. Many of these liabilities are subject to periodic audits by the respective taxing authority. Subsequent changes to our tax liabilities as a result of these audits may subject us to interest and penalties.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Effective January 1, 2007, the Government of Aruba (GOA) enacted a turnover tax on revenues from the sale of goods produced and services rendered in Aruba. The turnover tax, which is 3% for on-island sales and services and 1% on export sales, is being assessed by the GOA on sales by our Aruba Refinery. However, due to a previous tax holiday that was granted to our Aruba Refinery by the GOA through December 31, 2010 as well as other reasons, we believe that exports by our Aruba Refinery should not be subject to this turnover tax. Accordingly, through March 31, 2009, no expense or liability was recognized in our consolidated financial statements with respect to this turnover tax on exports. We commenced arbitration proceedings with the Netherlands Arbitration Institute pursuant to which we are seeking to enforce our rights under the tax holiday and other agreements related to the refinery. The arbitration hearing was held on February 3-4, 2009. We anticipate a decision sometime later this year. We have also filed protests of these assessments through proceedings in Aruba. In April 2008, we entered into an escrow agreement with the GOA and Caribbean Mercantile Bank NV (CMB), pursuant to which we agreed to deposit an amount equal to the disputed turnover tax on exports into an escrow account with CMB, pending resolution of the tax protest proceedings in Aruba. Under this escrow agreement, we are required to continue to deposit an amount equal to the disputed tax on a monthly basis until the tax dispute is resolved through the Aruba proceedings. Amounts deposited under this escrow agreement, which totaled \$110 million and \$102 million as of March 31, 2009 and December 31, 2008, respectively, are reflected as restricted cash in our consolidated balance sheets. On April 20, 2009, we were notified that the Aruban tax court overruled our protests with respect to the turnover tax assessed in January and February 2007, totaling \$8 million. Under the escrow agreement, we anticipate that \$8 million (plus applicable interest) will be paid to the GOA in the second quarter of 2009. The tax protests for the remaining periods remain outstanding.

In addition to the turnover tax described above, the GOA has also asserted other tax amounts aggregating approximately \$25 million related to dividends and other tax items. The GOA, through the arbitration, is also now questioning the validity of the tax holiday generally, although the GOA has never issued any formal assessment for profit tax at any time during the tax holiday period. We believe that the provisions of our tax holiday agreement exempt us from all of these taxes and, accordingly, no expense or liability has been recognized in our consolidated financial statements. We are also challenging approximately \$30 million in foreign exchange payments made to the Central Bank of Aruba as payments exempted under our tax holiday, as well as other reasons. These taxes and assessments are also being addressed in the arbitration proceedings discussed above.

***Litigation******MTBE Litigation***

As of May 1, 2009, we were named as a defendant in 32 active cases alleging liability related to MTBE contamination in groundwater. The plaintiffs are generally water providers, governmental authorities, and private water companies alleging that refiners and marketers of MTBE and gasoline containing MTBE are liable for manufacturing or distributing a defective product. We have been named in these lawsuits together with many other refining industry companies. We are being sued primarily as a refiner and marketer of MTBE and gasoline containing MTBE. We do not own or operate gasoline station facilities in most of the geographic locations in which damage is alleged to have occurred. The lawsuits generally seek individual, unquantified compensatory and punitive damages, injunctive relief, and attorneys' fees. Many of the cases are pending in federal court and are consolidated for pre-trial proceedings in the U.S. District Court for the Southern District of New York (Multi-District Litigation Docket No. 1358, *In re: Methyl-Tertiary Butyl Ether Products Liability Litigation*). Thirteen cases are pending in state court. The *City of New York* case is set for trial on June 22, 2009, in federal court.

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**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Village of Hempstead and West Hempstead Water District* will be set for trial in February 2010. Discovery is open in all cases. We believe that we have strong defenses to all claims and are vigorously defending the lawsuits.

We have recorded a loss contingency liability with respect to our MTBE litigation portfolio in accordance with FASB Statement No. 5, Accounting for Contingencies. However, due to the inherent uncertainty of litigation, we believe that it is reasonably possible (as defined in Statement No. 5) that we may suffer a loss with respect to one or more of the lawsuits in excess of the amount accrued. We believe that such an outcome in any one of these lawsuits would not have a material adverse effect on our results of operations or financial position. However, we believe that an adverse result in all or a substantial number of these cases could have a material effect on our results of operations and financial position. An estimate of the possible loss or range of loss from an adverse result in all or substantially all of these cases cannot reasonably be made.

*Retail Fuel Temperature Litigation*

As of May 1, 2009, we were named in 21 consumer class action lawsuits relating to fuel temperature. We have been named in these lawsuits together with several other defendants in the retail petroleum marketing business. The complaints, filed in federal courts in several states, allege that because fuel volume increases with fuel temperature, the defendants have violated state consumer protection laws by failing to adjust the volume of fuel when the fuel temperature exceeded 60 degrees Fahrenheit. The complaints seek to certify classes of retail consumers who purchased fuel in various locations. The complaints seek an order compelling the installation of temperature correction devices as well as monetary relief. The federal lawsuits are consolidated into a multi-district litigation case in the U.S. District Court for the District of Kansas (Multi-District Litigation Docket No. 1840, *In re: Motor Fuel Temperature Sales Practices Litigation*). Discovery has commenced. The court is expected to rule on certain class certification issues in 2009. We believe that we have several strong defenses to these lawsuits and intend to contest them. We have not recorded a loss contingency liability with respect to this matter, but due to the inherent uncertainty of litigation, we believe that it is reasonably possible (as defined in Statement No. 5) that we may suffer a loss with respect to one or more of the lawsuits. An estimate of the possible loss or range of loss from an adverse result in all or substantially all of these cases cannot reasonably be made.

*Rosolowski*

*Rosolowski v. Clark Refining & Marketing, Inc., et al.*, Judicial Circuit Court, Cook County, Illinois (Case No. 95-L-014703). We assumed this lawsuit in our acquisition of Premcor Inc. The lawsuit relates in part to a 1994 release to the atmosphere of spent catalyst from the now-closed Blue Island, Illinois refinery. The case was certified as a class action in 2000 with three classes, two of which received nominal or no damages, and one of which received a sizeable jury verdict. That class consisted of local residents who claimed property damage or loss of use and enjoyment of their property over a period of several years. In 2005, the jury returned a verdict for the plaintiffs of \$80 million in compensatory damages and \$40 million in punitive damages. However, following our motions for new trial and judgment notwithstanding the verdict (citing, among other things, misconduct by plaintiffs' counsel and improper class certification), the trial judge in 2006 vacated the jury's award and decertified the class. Plaintiffs appealed, and in June 2008 the state appeals court reversed the trial judge's decision to decertify the class and set aside the judgment. Thereafter, the Illinois Supreme Court refused to hear the case and returned it to the trial court. We have submitted renewed motions for judgment notwithstanding the verdict or, alternatively, a new trial. While we do not believe that the ultimate resolution of this matter

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES  
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

will have a material effect on our financial position or results of operations, we have recorded a loss contingency liability with respect to this matter in accordance with Statement No. 5.

*Other Litigation*

We are also a party to additional claims and legal proceedings arising in the ordinary course of business. We believe that there is only a remote likelihood that future costs related to known contingent liabilities related to these legal proceedings would have a material adverse impact on our consolidated results of operations or financial position.

**14. CONDENSED CONSOLIDATING FINANCIAL INFORMATION**

In conjunction with the acquisition of Premcor Inc. on September 1, 2005, Valero Energy Corporation has fully and unconditionally guaranteed the following debt of The Premcor Refining Group Inc. (PRG), a wholly owned subsidiary of Valero Energy Corporation, that was outstanding as of March 31, 2009:

- 6.75% senior notes due February 2011,
- 6.125% senior notes due May 2011,
- 6.75% senior notes due May 2014, and
- 7.5% senior notes due June 2015.

In addition, PRG has fully and unconditionally guaranteed all of the outstanding debt issued by Valero Energy Corporation.

The following condensed consolidating financial information is provided for Valero and PRG as an alternative to providing separate financial statements for PRG. The accounts for all companies reflected herein are presented using the equity method of accounting for investments in subsidiaries.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**Condensed Consolidating Balance Sheet as of March 31, 2009**  
**(unaudited, in millions)**

	<b>Valero Energy Corporation</b>	<b>PRG</b>	<b>Other Non- Guarantor Subsidiaries</b>	<b>Elimination</b>	<b>Consolidated</b>
<b>ASSETS</b>					
Current assets:					
Cash and temporary cash investments	\$ 677	\$	\$ 1,038	\$	\$ 1,715
Restricted cash	23	1	115		139
Receivables, net	12	35	3,109		3,156
Inventories		305	4,364		4,669
Income taxes receivable	62		86	(62)	86
Deferred income taxes			78		78
Prepaid expenses and other		7	618		625
<b>Total current assets</b>	<b>774</b>	<b>348</b>	<b>9,408</b>	<b>(62)</b>	<b>10,468</b>
Property, plant and equipment, at cost		6,116	22,528		28,644
Accumulated depreciation		(529)	(4,583)		(5,112)
<b>Property, plant and equipment, net</b>		<b>5,587</b>	<b>17,945</b>		<b>23,532</b>
Intangible assets, net			213		213
Investment in Valero Energy affiliates	6,552	2,838	(40)	(9,350)	
Long-term notes receivable from affiliates	15,887			(15,887)	
Deferred income tax receivable	902			(902)	
Deferred charges and other assets, net	120	128	1,315		1,563
<b>Total assets</b>	<b>\$ 24,235</b>	<b>\$ 8,901</b>	<b>\$ 28,841</b>	<b>\$ (26,201)</b>	<b>\$ 35,776</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>					
Current liabilities:					
Current portion of debt and capital lease obligations	\$ 209	\$	\$ 103	\$	\$ 312
Accounts payable	1	289	4,249		4,539
Accrued expenses	169	39	170		378
Taxes other than income taxes		11	490		501
Income taxes payable			64	(62)	2
Deferred income taxes	505				505
<b>Total current liabilities</b>	<b>884</b>	<b>339</b>	<b>5,076</b>	<b>(62)</b>	<b>6,237</b>
Debt and capital lease obligations, less current portion	6,330	898	36		7,264

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Long-term notes payable to affiliates	6,321	9,566	(15,887)	
Deferred income taxes	1,185	4,006	(902)	4,289
Other long-term liabilities	1,218	198	767	2,183
Stockholders' equity:				
Common stock	6	1	(1)	6
Additional paid-in capital	7,194	1,598	4,335	(5,933)
Treasury stock	(6,875)			(6,875)
Retained earnings	15,715	(1,628)	4,873	(3,245)
Accumulated other comprehensive income (loss)	(237)	(10)	181	(171)
Total stockholders' equity	15,803	(40)	9,390	(9,350)
Total liabilities and stockholders' equity	\$ 24,235	\$ 8,901	\$ 28,841	\$ (26,201)
				\$ 35,776

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**Condensed Consolidating Balance Sheet as of December 31, 2008**  
(in millions)

	<b>Valero Energy Corporation</b>	<b>PRG</b>	<b>Other Non- Guarantor Subsidiaries</b>	<b>Elimination</b>	<b>Consolidated</b>
<b>ASSETS</b>					
Current assets:					
Cash and temporary cash investments	\$ 215	\$	\$ 725	\$	\$ 940
Restricted cash	23	2	106		131
Receivables, net		36	2,861		2,897
Inventories		360	4,277		4,637
Income taxes receivable	76		197	(76)	197
Deferred income taxes			98		98
Prepaid expenses and other		8	542		550
Total current assets	314	406	8,806	(76)	9,450
Property, plant and equipment, at cost		6,025	22,078		28,103
Accumulated depreciation		(483)	(4,407)		(4,890)
Property, plant and equipment, net		5,542	17,671		23,213
Intangible assets, net			224		224
Investment in Valero Energy affiliates	6,300	2,718	65	(9,083)	
Long-term notes receivable from affiliates	15,354			(15,354)	
Deferred income tax receivable	883			(883)	
Deferred charges and other assets, net	121	136	1,273		1,530
Total assets	\$ 22,972	\$ 8,802	\$ 28,039	\$ (25,396)	\$ 34,417
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>					
Current liabilities:					
Current portion of debt and capital lease obligations	\$ 209	\$	\$ 103	\$	\$ 312
Accounts payable	43	414	3,989		4,446
Accrued expenses	82	34	258		374
Taxes other than income taxes		23	569		592
Income taxes payable		6	70	(76)	
Deferred income taxes	485				485
Total current liabilities	819	477	4,989	(76)	6,209
Debt and capital lease obligations, less current portion	5,329	899	36		6,264



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Long-term notes payable to affiliates		5,966	9,388	(15,354)	
Deferred income taxes		1,200	3,846	(883)	4,163
Other long-term liabilities	1,204	195	762		2,161
Stockholders' equity:					
Common stock	6		1	(1)	6
Additional paid-in capital	7,190	1,598	4,349	(5,947)	7,190
Treasury stock	(6,884)				(6,884)
Retained earnings	15,484	(1,523)	4,507	(2,984)	15,484
Accumulated other comprehensive income (loss)	(176)	(10)	161	(151)	(176)
Total stockholders' equity	15,620	65	9,018	(9,083)	15,620
Total liabilities and stockholders' equity	\$ 22,972	\$ 8,802	\$ 28,039	\$ (25,396)	\$ 34,417

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**Condensed Consolidating Statement of Income for the Three Months Ended March 31, 2009**  
**(unaudited, in millions)**

	<b>Valero Energy Corporation</b>	<b>PRG</b>	<b>Other Non- Guarantor Subsidiaries</b>	<b>Elimination</b>	<b>Consolidated</b>
Operating revenues	\$	\$ 2,734	\$ 13,704	\$ (2,614)	\$ 13,824
Costs and expenses:					
Cost of sales		2,706	11,536	(2,614)	11,628
Refining operating expenses		239	758		997
Retail selling expenses			169		169
General and administrative expenses	(2)	1	146		145
Depreciation and amortization expense		64	314		378
Total costs and expenses	(2)	3,010	12,923	(2,614)	13,317
Operating income (loss)	2	(276)	781		507
Equity in earnings (losses) of subsidiaries	248	120	(105)	(263)	
Other income (expense), net	255	(14)	161	(403)	(1)
Interest and debt expense:					
Incurred	(143)	(115)	(264)	403	(119)
Capitalized		7	33		40
Income (loss) before income tax expense (benefit)	362	(278)	606	(263)	427
Income tax expense (benefit) (1)	53	(173)	238		118
Net income (loss)	\$ 309	\$ (105)	\$ 368	\$ (263)	\$ 309

(1) The income tax expense (benefit) reflected in each column does not include any tax effect of the equity in earnings (losses) of subsidiaries.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**Condensed Consolidating Statement of Income for the Three Months Ended March 31, 2008**  
**(unaudited, in millions)**

	<b>Valero Energy Corporation</b>	<b>PRG</b>	<b>Other Non- Guarantor Subsidiaries</b>	<b>Elimination</b>	<b>Consolidated</b>
Operating revenues	\$	\$ 7,674	\$ 27,605	\$ (7,334)	\$ 27,945
Costs and expenses:					
Cost of sales		7,419	25,584	(7,334)	25,669
Refining operating expenses		234	880		1,114
Retail selling expenses			188		188
General and administrative expenses	(1)	13	123		135
Depreciation and amortization expense		78	289		367
Total costs and expenses	(1)	7,744	27,064	(7,334)	27,473
Operating income (loss)	1	(70)	541		472
Equity in earnings (losses) of subsidiaries	136	39	(121)	(54)	
Other income (expense), net	292	(8)	192	(456)	20
Interest and debt expense:					
Incurred	(137)	(148)	(287)	456	(116)
Capitalized		4	15		19
Income (loss) before income tax expense (benefit)	292	(183)	340	(54)	395
Income tax expense (benefit) (1)	31	(62)	165		134
Net income (loss)	\$ 261	\$ (121)	\$ 175	\$ (54)	\$ 261

(1) The income tax expense (benefit) reflected in each column does not include any tax effect of the equity in earnings (losses) of subsidiaries.

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**Condensed Consolidating Statement of Cash Flows for the Three Months Ended March 31, 2009**  
**(unaudited, in millions)**

	<b>Valero Energy Corporation</b>	<b>PRG</b>	<b>Other Non- Guarantor Subsidiaries</b>	<b>Elimination</b>	<b>Consolidated</b>
Net cash provided by (used in) operating activities	\$ 135	\$ (201)	\$ 847	\$	\$ 781
Cash flows from investing activities:					
Capital expenditures		(140)	(595)		(735)
Deferred turnaround and catalyst costs		(13)	(154)		(167)
Advance payments related to purchase of certain VeraSun Energy Corporation facilities			(13)		(13)
Net intercompany loans	(588)			588	
Other investing activities, net			6		6
Net cash used in investing activities	(588)	(153)	(756)	588	(909)
Cash flows from financing activities:					
Non-bank debt borrowings	998				998
Accounts receivable sales program:					
Proceeds from sale of receivables			100		100
Repayments			(100)		(100)
Issuance of common stock in connection with employee benefit plans	1				1
Benefit from tax deduction in excess of recognized stock-based compensation cost	1				1
Common stock dividends	(77)				(77)
Net intercompany borrowings		354	234	(588)	
Debt issuance costs	(7)				(7)
Other financing activities	(1)		(1)		(2)
Net cash provided by financing activities	915	354	233	(588)	914
Effect of foreign exchange rate changes on cash			(11)		(11)
Net increase in cash and temporary cash investments	462		313		775
Cash and temporary cash investments at beginning of period	215		725		940
Cash and temporary cash investments at end of period	\$ 677	\$	\$ 1,038	\$	\$ 1,715

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**VALERO ENERGY CORPORATION AND SUBSIDIARIES**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**Condensed Consolidating Statement of Cash Flows for the Three Months Ended March 31, 2008**  
**(unaudited, in millions)**

	<b>Valero Energy Corporation</b>	<b>PRG</b>	<b>Other Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net cash provided by operating activities	\$ 124	\$ 32	\$ 472	\$	\$ 628
Cash flows from investing activities:					
Capital expenditures		(106)	(431)		(537)
Deferred turnaround and catalyst costs		(10)	(93)		(103)
Contingent payment in connection with acquisition			(25)		(25)
Net intercompany loans	(171)			171	
Minor acquisition			(57)		(57)
Other investing activities, net			6		6
Net cash used in investing activities	(171)	(116)	(600)	171	(716)
Cash flows from financing activities:					
Non-bank debt repayments	(6)	(368)			(374)
Purchase of common stock for treasury	(518)				(518)
Issuance of common stock in connection with employee benefit plans	7				7
Benefit from tax deduction in excess of recognized stock-based compensation cost	8				8
Common stock dividends	(64)				(64)
Net intercompany borrowings (repayments)		452	(281)	(171)	
Net cash provided by (used in) financing activities	(573)	84	(281)	(171)	(941)
Effect of foreign exchange rate changes on cash			(4)		(4)
Net decrease in cash and temporary cash investments	(620)		(413)		(1,033)
Cash and temporary cash investments at beginning of period	1,414		1,050		2,464
Cash and temporary cash investments at end of period	\$ 794	\$	\$ 637	\$	\$ 1,431

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

***CAUTIONARY STATEMENT FOR THE PURPOSE OF SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995***

This Form 10-Q, including without limitation our discussion below under the heading *Results of Operations Outlook*, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify our forward-looking statements by the words anticipate, believe, expect, plan, intend, estimate, project, projection, predict, budget, forecast, could, should, may, and similar expressions.

These forward-looking statements include, among other things, statements regarding:

- future refining margins, including gasoline and distillate margins;
- future retail margins, including gasoline, diesel, home heating oil, and convenience store merchandise margins;
- expectations regarding feedstock costs, including crude oil differentials, and operating expenses;
- anticipated levels of crude oil and refined product inventories;
- our anticipated level of capital investments, including deferred refinery turnaround and catalyst costs and capital expenditures for environmental and other purposes, and the effect of those capital investments on our results of operations;
- anticipated trends in the supply of and demand for crude oil and other feedstocks and refined products in the United States, Canada, and elsewhere;
- expectations regarding environmental, tax, and other regulatory initiatives; and
- the effect of general economic and other conditions on refining and retail industry fundamentals.

We based our forward-looking statements on our current expectations, estimates, and projections about ourselves and our industry. We caution that these statements are not guarantees of future performance and involve risks, uncertainties, and assumptions that we cannot predict. In addition, we based many of these forward-looking statements on assumptions about future events that may prove to be inaccurate. Accordingly, our actual results may differ materially from the future performance that we have expressed or forecast in the forward-looking statements. Differences between actual results and any future performance suggested in these forward-looking statements could result from a variety of factors, including the following:

- acts of terrorism aimed at either our facilities or other facilities that could impair our ability to produce or transport refined products or receive feedstocks;
- political and economic conditions in nations that consume refined products, including the United States, and in crude oil producing regions, including the Middle East and South America;
- the domestic and foreign supplies of refined products such as gasoline, diesel fuel, jet fuel, home heating oil, and petrochemicals;
- the domestic and foreign supplies of crude oil and other feedstocks;
- the ability of the members of the Organization of Petroleum Exporting Countries (OPEC) to agree on and to maintain crude oil price and production controls;
- the level of consumer demand, including seasonal fluctuations;
- refinery overcapacity or undercapacity;
- the actions taken by competitors, including both pricing and adjustments to refining capacity in response to market conditions;
- environmental, tax, and other regulations at the municipal, state, and federal levels and in foreign countries;

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the level of foreign imports of refined products;  
accidents or other unscheduled shutdowns affecting our refineries, machinery, pipelines, or equipment, or those of our suppliers or customers;  
changes in the cost or availability of transportation for feedstocks and refined products;  
the price, availability, and acceptance of alternative fuels and alternative-fuel vehicles;  
delay of, cancellation of, or failure to implement planned capital projects and realize the various assumptions and benefits projected for such projects or cost overruns in constructing such planned capital projects;  
earthquakes, hurricanes, tornadoes, and irregular weather, which can unforeseeably affect the price or availability of natural gas, crude oil and other feedstocks, and refined products;  
rulings, judgments, or settlements in litigation or other legal or regulatory matters, including unexpected environmental remediation costs, in excess of any reserves or insurance coverage;  
legislative or regulatory action, including the introduction or enactment of federal, state, municipal, or foreign legislation or rulemakings, which may adversely affect our business or operations;  
changes in the credit ratings assigned to our debt securities and trade credit;  
changes in currency exchange rates, including the value of the Canadian dollar relative to the U.S. dollar; and  
overall economic conditions, including the stability and liquidity of financial markets.

Any one of these factors, or a combination of these factors, could materially affect our future results of operations and whether any forward-looking statements ultimately prove to be accurate. Our forward-looking statements are not guarantees of future performance, and actual results and future performance may differ materially from those suggested in any forward-looking statements. We do not intend to update these statements unless we are required by the securities laws to do so.

All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the foregoing. We undertake no obligation to publicly release the results of any revisions to any such forward-looking statements that may be made to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

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***OVERVIEW***

In this overview, we describe some of the primary factors that we believe affected our results of operations in the first quarter of 2009. We reported net income of \$309 million, or \$0.59 per share, for the first quarter of 2009, compared to \$261 million, or \$0.48 per share, for the first quarter of 2008. The results of operations for the first quarter of 2008 included a pre-tax benefit of approximately \$100 million for a business interruption insurance settlement related to a 2007 fire at our McKee Refinery.

Our profitability is substantially determined by the spread between the price of refined products and the price of crude oil, referred to as the refined product margin. The current economic recession has caused a decline in demand for refined products, which put pressure on refined product margins during the first quarter of 2009. However, relatively low retail pump prices for gasoline resulting from declining costs of crude oil and other feedstocks helped to support gasoline margins during the first quarter of 2009, and as a result, gasoline margins were unseasonably strong and improved significantly in the first quarter of 2009 compared to the prior year first quarter. The lower costs of crude oil and other feedstocks also significantly improved margins on certain secondary products, such as asphalt, fuel oils, and petroleum coke, during the first quarter of 2009. Distillate margins continued to be favorable in the first quarter of 2009, but declined compared to the high margins in the first quarter of 2008 primarily due to increased inventory levels and reduced demand caused by a reduction in global economic activity.

Because more than 65% of our total crude oil throughput generally consists of sour crude oil and acidic sweet crude oil feedstocks that historically have been purchased at prices less than sweet crude oil, our profitability is also significantly affected by the spread between sweet crude oil and sour crude oil prices, referred to as the sour crude oil differential. First quarter 2009 sour crude oil differentials decreased significantly and were substantially lower than the 2008 first quarter differentials. This decline in sour crude oil differentials was partially caused by a disproportionate reduction in sour crude oil production by OPEC, which reduced the supply of sour crude oil and increased the price of sour crude oils relative to sweet crude oils.

In February 2009, we made an offer to VeraSun Energy Corporation (VeraSun) to purchase five existing ethanol plants and a site currently under development in conjunction with VeraSun's bankruptcy proceedings. In March 2009, the bankruptcy court approved our purchase of these six facilities as well as two additional VeraSun ethanol plants available in the bankruptcy proceedings. In April 2009, we closed on the acquisition of all but one of these facilities, with the closing on the acquisition of the final facility expected later in the second quarter of 2009.

In March 2009, we issued \$750 million of 10-year notes and \$250 million of 30-year notes. Proceeds from these notes have been used to make \$209 million of scheduled debt payments in April 2009, fund our acquisition of the ethanol plants from VeraSun, and maintain our capital investment program.



**Table of Contents****RESULTS OF OPERATIONS****First Quarter 2009 Compared to First Quarter 2008****Financial Highlights***(millions of dollars, except per share amounts)*

	<b>Three Months Ended March 31,</b>		
	<b>2009</b>	<b>2008 (a)</b>	<b>Change</b>
Operating revenues	\$ 13,824	\$ 27,945	\$ (14,121)
Costs and expenses:			
Cost of sales	11,628	25,669	(14,041)
Refining operating expenses	997	1,114	(117)
Retail selling expenses	169	188	(19)
General and administrative expenses	145	135	10
Depreciation and amortization expense:			
Refining	344	331	13
Retail	23	25	(2)
Corporate	11	11	
Total costs and expenses	13,317	27,473	(14,156)
Operating income	507	472	35
Other income (expense), net	(1)	20	(21)
Interest and debt expense:			
Incurred	(119)	(116)	(3)
Capitalized	40	19	21
Income before income tax expense	427	395	32
Income tax expense	118	134	(16)
Net income	\$ 309	\$ 261	\$ 48
Earnings per common share assuming dilution	\$ 0.59	\$ 0.48	\$ 0.11

See the footnote  
references on page  
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**Operating Highlights**  
*(millions of dollars, except per barrel and per gallon amounts)*

	<b>Three Months Ended March 31,</b>		
	<b>2009</b>	<b>2008</b>	<b>Change</b>
<b>Refining:</b>			
Operating income	\$ 607	\$ 568	\$ 39
Throughput margin per barrel (b)	\$ 8.77	\$ 8.48	\$ 0.29
Operating costs per barrel:			
Refining operating expenses	\$ 4.49	\$ 4.69	\$ (0.20)
Depreciation and amortization	1.55	1.40	0.15
Total operating costs per barrel	\$ 6.04	\$ 6.09	\$ (0.05)
Throughput volumes (thousand barrels per day):			
Feedstocks:			
Heavy sour crude	572	582	(10)
Medium/light sour crude	625	656	(31)
Acidic sweet crude	112	73	39
Sweet crude	562	629	(67)
Residuals	113	192	(79)
Other feedstocks	171	159	12
Total feedstocks	2,155	2,291	(136)
Blendstocks and other	312	318	(6)
Total throughput volumes	2,467	2,609	(142)
Yields (thousand barrels per day):			
Gasolines and blendstocks	1,123	1,224	(101)
Distillates	832	872	(40)
Petrochemicals	61	77	(16)
Other products (c)	441	438	3
Total yields	2,457	2,611	(154)
<b>Retail U.S.:</b>			
Operating income	\$ 25	\$ 14	\$ 11
Company-operated fuel sites (average)	1,004	950	54
Fuel volumes (gallons per day per site)	4,984	4,942	42
Fuel margin per gallon	\$ 0.117	\$ 0.112	\$ 0.005
Merchandise sales	\$ 266	\$ 245	\$ 21
Merchandise margin (percentage of sales)	30.4%	30.5%	(0.1)%
Margin on miscellaneous sales	\$ 23	\$ 28	\$ (5)
Retail selling expenses	\$ 114	\$ 120	\$ (6)

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Depreciation and amortization expense	\$ 17	\$ 17	\$
<b>Retail Canada:</b>			
Operating income	\$ 31	\$ 36	\$ (5)
Fuel volumes (thousand gallons per day)	3,260	3,278	(18)
Fuel margin per gallon	\$ 0.250	\$ 0.301	\$ (0.051)
Merchandise sales	\$ 39	\$ 46	\$ (7)
Merchandise margin (percentage of sales)	29.9%	28.3%	1.6%
Margin on miscellaneous sales	\$ 8	\$ 9	\$ (1)
Retail selling expenses	\$ 55	\$ 68	\$ (13)
Depreciation and amortization expense	\$ 6	\$ 8	\$ (2)

See the footnote  
references on page  
40.

**Table of Contents****Refining Operating Highlights by Region (d)**  
*(millions of dollars, except per barrel amounts)*

	<b>Three Months Ended March 31,</b>		
	<b>2009</b>	<b>2008</b>	<b>Change</b>
<b>Gulf Coast (a):</b>			
Operating income	\$ 169	\$ 437	\$ (268)
Throughput volumes (thousand barrels per day)	1,315	1,380	(65)
Throughput margin per barrel (b)	\$ 7.13	\$ 9.51	\$ (2.38)
Operating costs per barrel:			
Refining operating expenses	\$ 4.19	\$ 4.72	\$ (0.53)
Depreciation and amortization	1.51	1.31	0.20
Total operating costs per barrel	\$ 5.70	\$ 6.03	\$ (0.33)
<b>Mid-Continent:</b>			
Operating income	\$ 172	\$ 115	\$ 57
Throughput volumes (thousand barrels per day)	400	412	(12)
Throughput margin per barrel (b)	\$ 9.98	\$ 8.74	\$ 1.24
Operating costs per barrel:			
Refining operating expenses	\$ 3.74	\$ 4.34	\$ (0.60)
Depreciation and amortization	1.47	1.33	0.14
Total operating costs per barrel	\$ 5.21	\$ 5.67	\$ (0.46)
<b>Northeast:</b>			
Operating income	\$ 81	\$ 5	\$ 76
Throughput volumes (thousand barrels per day)	476	556	(80)
Throughput margin per barrel (b)	\$ 9.03	\$ 6.00	\$ 3.03
Operating costs per barrel:			
Refining operating expenses	\$ 5.57	\$ 4.50	\$ 1.07
Depreciation and amortization	1.57	1.41	0.16
Total operating costs per barrel	\$ 7.14	\$ 5.91	\$ 1.23
<b>West Coast:</b>			
Operating income	\$ 185	\$ 11	\$ 174
Throughput volumes (thousand barrels per day)	276	261	15
Throughput margin per barrel (b)	\$ 14.40	\$ 7.89	\$ 6.51
Operating costs per barrel:			
Refining operating expenses	\$ 5.10	\$ 5.56	\$ (0.46)
Depreciation and amortization	1.83	1.87	(0.04)
Total operating costs per barrel	\$ 6.93	\$ 7.43	\$ (0.50)

See the footnote  
references on page  
40.

**Table of Contents***Average Market Reference Prices and Differentials (e)*  
*(dollars per barrel)*

	<b>Three Months Ended March 31,</b>		
	<b>2009</b>	<b>2008</b>	<b>Change</b>
<b>Feedstocks:</b>			
West Texas Intermediate (WTI) crude oil	\$ 42.97	\$ 97.94	\$ (54.97)
WTI less sour crude oil at U.S. Gulf Coast (f)	1.71	5.84	(4.13)
WTI less Mars crude oil	(0.78)	6.97	(7.75)
WTI less Maya crude oil	4.46	16.81	(12.35)
<b>Products:</b>			
<b>U.S. Gulf Coast:</b>			
Conventional 87 gasoline less WTI	8.14	4.23	3.91
No. 2 fuel oil less WTI	10.85	15.20	(4.35)
Ultra-low-sulfur diesel less WTI	15.04	20.37	(5.33)
Propylene less WTI	(6.49)	(0.77)	(5.72)
<b>U.S. Mid-Continent:</b>			
Conventional 87 gasoline less WTI	8.58	4.97	3.61
Low-sulfur diesel less WTI	11.64	20.92	(9.28)
<b>U.S. Northeast:</b>			
Conventional 87 gasoline less WTI	8.14	3.07	5.07
No. 2 fuel oil less WTI	13.43	17.76	(4.33)
Lube oils less WTI	67.10	32.29	34.81
<b>U.S. West Coast:</b>			
CARBOB 87 gasoline less WTI	19.13	9.04	10.09
CARB diesel less WTI	13.70	19.95	(6.25)

The following notes relate to references on pages 37 through 40.

- (a) Effective July 1, 2008, we sold our Krotz Springs Refinery to Alon Refining Krotz Springs, Inc. (Alon), a subsidiary of Alon USA Energy, Inc. The nature and significance of our post-closing participation in an offtake agreement with Alon represents a continuation of activities with the Krotz Springs Refinery for accounting purposes, and as such the results of operations related to the Krotz Springs Refinery have not been presented as discontinued operations, and all refining operating highlights, both consolidated and for the Gulf Coast region, include the Krotz Spring Refinery for the three months ended March 31, 2008.
- (b) Throughput margin per barrel represents operating revenues less cost of sales divided by throughput volumes.
- (c) Other products primarily include gas oils, No. 6 fuel oil, petroleum coke, and asphalt.
- (d) The regions reflected herein contain the following refineries: the Gulf Coast refining region includes the Corpus Christi East, Corpus Christi West, Texas City, Houston, Three Rivers, Krotz Springs (for the three months ended March 31, 2008), St. Charles, Aruba, and Port Arthur Refineries; the Mid-Continent refining region includes the McKee, Ardmore, and Memphis Refineries; the Northeast refining region includes the Quebec City, Paulsboro, and Delaware City Refineries; and the West Coast refining region includes the Benicia and Wilmington Refineries.
- (e) The average market reference prices and differentials, with the exception of the propylene and lube oil differentials, are based on posted prices from Platts Oilgram. The propylene differential is based on posted propylene prices in Chemical Market Associates, Inc. and the lube oil differential is based on Exxon Mobil Corporation postings provided by Independent Commodity Information Services London Oil Reports. The average market reference prices and differentials are presented to provide users of the consolidated financial

statements with economic indicators that significantly affect our operations and profitability.

- (f) The market reference differential for sour crude oil is based on 50% Arab Medium and 50% Arab Light posted prices.

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**General**

Operating revenues decreased 51% for the first quarter of 2009 compared to the first quarter of 2008 primarily as a result of lower refined product prices between the two periods. Operating income of \$507 million and net income of \$309 million for the three months ended March 31, 2009 increased 7% and 18%, respectively, from the corresponding amounts in the first quarter of 2008 primarily due to a \$39 million increase in refining segment operating income discussed below.

**Refining**

Operating income for our refining segment increased from \$568 million for the first quarter of 2008 to \$607 million for the first quarter of 2009, resulting from a 3% increase in throughput margin per barrel and a 7% decrease in refining operating expenses (including depreciation and amortization expense), partially offset by a 5% decline in throughput volumes.

Total refining throughput margins for the first quarter of 2009 compared to the first quarter of 2008 were impacted by the following factors:

Gasoline margins were unseasonably strong in all of our refining regions in the first quarter of 2009, and were almost double the margins in the first quarter of 2008. The improvement in gasoline margins for the first quarter of 2009 was primarily due to a significant decrease in the cost of crude oil and other feedstocks, which contributed to lower retail pump prices that supported gasoline demand.

Distillate margins in the first quarter of 2009 remained favorable, but decreased in all of our refining regions from the high margins in the first quarter of 2008. The decrease in distillate margins was primarily due to increased inventory levels and reduced demand attributable to the global slowdown in economic activity. Margins on various secondary refined products such as asphalt, fuel oils, and petroleum coke improved significantly from the first quarter of 2008 to the first quarter of 2009 as prices for these products did not decrease in proportion to the large decrease in the costs of the feedstocks used to produce them.

Sour crude oil feedstock differentials to WTI crude oil during the first quarter of 2009 declined significantly compared to the differentials in the first quarter of 2008. These unfavorable sour crude oil differentials were attributable mainly to reduced production of heavy sour crude oil by OPEC and the relatively low price of WTI crude oil.

Throughput margin for the first quarter of 2008 included approximately \$100 million related to the McKee Refinery business interruption insurance settlement discussed in Note 13 of Condensed Notes to Consolidated Financial Statements.

Throughput volumes decreased 142,000 barrels per day during the first quarter of 2009 compared to the first quarter of 2008 primarily due to (i) unplanned downtime at our Port Arthur and Delaware City Refineries, (ii) planned downtime for maintenance at our Texas City, St. Charles, and Corpus Christi Refineries, and (iii) the sale of our Krotz Springs Refinery in July 2008.

Refining operating expenses, excluding depreciation and amortization expense, were 11% lower for the quarter ended March 31, 2009 compared to the quarter ended March 31, 2008 primarily due to decreases in energy costs and maintenance expense and \$23 million of operating expenses in the first quarter of 2008 related to the Krotz Springs Refinery, which was sold effective July 1, 2008. Refining depreciation and amortization expense increased 4% from the first quarter of 2008 to the first quarter of 2009 primarily due to the completion of new capital projects and increased turnaround and catalyst amortization.



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**Retail**

Retail operating income was \$56 million for the quarter ended March 31, 2009 compared to \$50 million for the quarter ended March 31, 2008. This 12% increase was primarily due to lower selling expenses and improved fuel margins in our U.S. retail operations, partially offset by reduced operating income in our Canadian retail operations attributable largely to a decrease in the Canadian dollar exchange rate relative to the U.S. dollar.

**Corporate Expenses and Other**

General and administrative expenses increased \$10 million from the first quarter of 2008 to the first quarter of 2009 due mainly to an increase in severance expenses.

Other income (expense), net for the first quarter of 2009 decreased from the first quarter of 2008 primarily due to reduced interest income resulting from lower cash balances and interest rates combined with the nonrecurrence of a \$14 million gain recognized in the first quarter of 2008 on the redemption of our 9.5% senior notes as discussed in Note 5 of Condensed Notes to Consolidated Financial Statements.

Interest and debt expense decreased from the first quarter of 2008 to the first quarter of 2009 due mainly to an increase in capitalized interest resulting from a higher balance of capital projects under construction, partially offset by interest incurred on \$1 billion of debt issued on March 12, 2009.

Income tax expense decreased \$16 million from the first quarter of 2008 to the first quarter of 2009 mainly as a result of a lower effective tax rate for the first quarter of 2009 primarily due to an increase in the proportion of pre-tax income contributed by the Aruba Refinery, the profits of which are non-taxable in Aruba through December 31, 2010.

***OUTLOOK***

We expect the current global economic slowdown and rising unemployment to continue to unfavorably impact demand for refined products, which will put continuing pressure on refined product margins. With respect to the gasoline market, however, the current relatively low prices of crude oil and other feedstocks have contributed to retail pump prices that are significantly lower than this time last year, and these lower pump prices could result in improved demand as the summer driving season approaches. On the other hand, distillate margins for the second and third quarters of 2009 are expected to continue to be unfavorably affected by reduced demand attributable to the current economic recession. We believe that refined product margins will continue to depend primarily on the level of global economic activity and the rate at which new refining capacity is brought online.

In regard to feedstocks, thus far in 2009, sour crude oil differentials have decreased significantly from fourth quarter 2008 levels and are expected to remain lower until demand for crude oil increases. Increased crude oil demand will depend on the global rate of recovery from the current economic recession. Until demand improves, reduced overall crude oil production by OPEC is expected to continue, which will reduce the supply of sour crude oil and increase the price of such crude oils relative to sweet crude oils. We expect the remainder of 2009 will continue to be a challenging period for the refining industry and our company in light of the current economic environment.

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***LIQUIDITY AND CAPITAL RESOURCES***

***Cash Flows for the Three Months Ended March 31, 2009 and 2008***

Net cash provided by operating activities for the three months ended March 31, 2009 was \$781 million compared to \$628 million for the three months ended March 31, 2008. The increase in cash generated from operating activities was primarily due to the increase in operating income discussed above under *Results of Operations* and a favorable change in the amount of income tax payments and refunds between the two periods, partially offset by an unfavorable change in other working capital components between the periods. Changes in cash provided by or used for working capital during the first three months of 2009 and 2008 are shown in Note 8 of Condensed Notes to Consolidated Financial Statements.

The net cash generated from operating activities during the first three months of 2009, combined with \$998 million of proceeds from the issuance of \$1 billion of notes in March 2009 as discussed in Note 5 of Condensed Notes to Consolidated Financial Statements, were used mainly to:

- fund \$902 million of capital expenditures and deferred turnaround and catalyst costs;
- pay common stock dividends of \$77 million;
- make a \$13 million advance payment for the purchase of certain VeraSun facilities; and
- increase available cash on hand by \$775 million.

The net cash generated from operating activities during the first three months of 2008, combined with \$1.0 billion of available cash on hand, were used mainly to:

- fund \$640 million of capital expenditures and deferred turnaround and catalyst costs;
- make an early redemption of our 9.5% senior notes for \$367 million and scheduled long-term note repayments of \$7 million;
- purchase 8.8 million shares of our common stock at a cost of \$518 million;
- fund a \$25 million contingent earn-out payment in connection with the acquisition of the St. Charles Refinery and a \$57 million acquisition primarily of an interest in a refined product pipeline; and
- pay common stock dividends of \$64 million.

***Capital Investments***

During the three months ended March 31, 2009, we expended \$735 million for capital expenditures and \$167 million for deferred turnaround and catalyst costs. Capital expenditures for the three months ended March 31, 2009 included \$94 million of costs related to environmental projects.

For 2009, we expect to incur approximately \$2.5 billion for capital investments, including approximately \$2.1 billion for capital expenditures (approximately \$520 million of which is for environmental projects) and approximately \$430 million for deferred turnaround and catalyst costs. The capital expenditure estimate excludes expenditures related to strategic acquisitions. We continuously evaluate our capital budget and make changes as economic conditions warrant.

In April 2009, we completed the purchase of six ethanol facilities and a site currently under development from VeraSun for a purchase price of \$422 million, plus approximately \$75 million for inventory and certain other working capital. We expect to complete the purchase of one additional ethanol facility for a purchase price of \$55 million later in the second quarter of 2009.

***Contractual Obligations***

As of March 31, 2009, our contractual obligations included debt, capital lease obligations, operating leases, purchase obligations, and other long-term liabilities.

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In March 2009, we issued \$750 million of 9.375% notes due March 15, 2019 and \$250 million of 10.5% notes due March 15, 2039. Proceeds from the issuance of these notes totaled approximately \$998 million, before deducting underwriting discounts of \$7 million.

We have an accounts receivable sales facility with a group of third-party entities and financial institutions to sell on a revolving basis up to \$1 billion of eligible trade receivables, which matures in June 2009. As of December 31, 2008, the amount of eligible receivables sold to the third-party entities and financial institutions was \$100 million, which was repaid in February 2009. In March 2009, we sold \$100 million of eligible receivables to the third-party entities and financial institutions, which remained outstanding as of March 31, 2009. In April 2009, we sold an additional \$400 million of eligible receivables under this program.

During the three months ended March 31, 2009, we had no material changes outside the ordinary course of our business in capital lease obligations, operating leases, purchase obligations, or other long-term liabilities.

Our agreements do not have rating agency triggers that would automatically require us to post additional collateral. However, in the event of certain downgrades of our senior unsecured debt to below investment grade ratings by Moody's Investors Service and Standard & Poor's Ratings Services, the cost of borrowings under some of our bank credit facilities and other arrangements would increase. As of March 31, 2009, all of our ratings on our senior unsecured debt are at or above investment grade level as follows:

<b>Rating Agency</b>	<b>Rating</b>
Standard & Poor's Ratings Services	BBB (stable outlook)
Moody's Investors Service	Baa2 (stable outlook)
Fitch Ratings	BBB (stable outlook)

We cannot provide assurance that these ratings will remain in effect for any given period of time or that one or more of these ratings will not be lowered or withdrawn entirely by a rating agency. We note that these credit ratings are not recommendations to buy, sell, or hold our securities and may be revised or withdrawn at any time by the rating agency. Each rating should be evaluated independently of any other rating. Any future reduction or withdrawal of one or more of our credit ratings could have a material adverse impact on our ability to obtain short- and long-term financing and the cost of such financings.

***Other Commercial Commitments***

As of March 31, 2009, our committed lines of credit were as follows:

	<b>Borrowing Capacity</b>	<b>Expiration</b>
Letter of credit facility	\$300 million	June 2009
Letter of credit facility	\$275 million	July 2009
Revolving credit facility	\$2.5 billion	November 2012
Canadian revolving credit facility	Cdn. \$115 million	December 2012

As of March 31, 2009, we had \$218 million of letters of credit outstanding under our uncommitted short-term bank credit facilities and \$224 million of letters of credit outstanding under our three U.S. committed revolving credit facilities. Under our Canadian committed revolving credit facility, we had Cdn. \$19 million of letters of credit outstanding as of March 31, 2009. Our letters of credit expire during 2009 and 2010.

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***Stock Purchase Programs***

As of March 31, 2009, we have approvals under common stock purchase programs previously approved by our board of directors to purchase approximately \$3.5 billion of our common stock.

***Tax Matters***

As discussed in Note 13 of Condensed Notes to Consolidated Financial Statements, we are subject to extensive tax liabilities. New tax laws and regulations and changes in existing tax laws and regulations are continuously being enacted or proposed that could result in increased expenditures for tax liabilities in the future. Many of these liabilities are subject to periodic audits by the respective taxing authority. Subsequent changes to our tax liabilities as a result of these audits may subject us to interest and penalties.

Effective January 1, 2007, the Government of Aruba (GOA) enacted a turnover tax on revenues from the sale of goods produced and services rendered in Aruba. The turnover tax, which is 3% for on-island sales and services and 1% on export sales, is being assessed by the GOA on sales by our Aruba Refinery. However, due to a previous tax holiday that was granted to our Aruba Refinery by the GOA through December 31, 2010 as well as other reasons, we believe that exports by our Aruba Refinery should not be subject to this turnover tax. Accordingly, through March 31, 2009, no expense or liability was recognized in our consolidated financial statements with respect to this turnover tax on exports. We commenced arbitration proceedings with the Netherlands Arbitration Institute pursuant to which we are seeking to enforce our rights under the tax holiday and other agreements related to the refinery. The arbitration hearing was held on February 3-4, 2009. We anticipate a decision sometime later this year. We have also filed protests of these assessments through proceedings in Aruba. In April 2008, we entered into an escrow agreement with the GOA and Caribbean Mercantile Bank NV (CMB), pursuant to which we agreed to deposit an amount equal to the disputed turnover tax on exports into an escrow account with CMB, pending resolution of the tax protest proceedings in Aruba. Under this escrow agreement, we are required to continue to deposit an amount equal to the disputed tax on a monthly basis until the tax dispute is resolved through the Aruba proceedings. Amounts deposited under this escrow agreement, which totaled \$110 million and \$102 million as of March 31, 2009 and December 31, 2008, respectively, are reflected as restricted cash in our consolidated balance sheets. On April 20, 2009, we were notified that the Aruban tax court overruled our protests with respect to the turnover tax assessed in January and February 2007, totaling \$8 million. Under the escrow agreement, we anticipate that \$8 million (plus applicable interest) will be paid to the GOA in the second quarter of 2009. The tax protests for the remaining periods remain outstanding.

In addition to the turnover tax described above, the GOA has also asserted other tax amounts aggregating approximately \$25 million related to dividends and other tax items. The GOA, through the arbitration, is also now questioning the validity of the tax holiday generally, although the GOA has never issued any formal assessment for profit tax at any time during the tax holiday period. We believe that the provisions of our tax holiday agreement exempt us from all of these taxes and, accordingly, no expense or liability has been recognized in our consolidated financial statements. We are also challenging approximately \$30 million in foreign exchange payments made to the Central Bank of Aruba as payments exempted under our tax holiday, as well as other reasons. These taxes and assessments are also being addressed in the arbitration proceedings discussed above.

***Other***

In January 2009, we contributed \$50 million to our main qualified pension plan. We expect to contribute a total of approximately \$130 million to our qualified pension plans during 2009.

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In November 2007, we announced plans to explore strategic alternatives related to our Aruba Refinery. We are continuing to pursue potential transactions for this refinery, which may include the sale of the refinery.

We are subject to extensive federal, state, and local environmental laws and regulations, including those relating to the discharge of materials into the environment, waste management, pollution prevention measures, greenhouse gas emissions, and characteristics and composition of gasolines and distillates. Because environmental laws and regulations are becoming more complex and stringent and new environmental laws and regulations are continuously being enacted or proposed, the level of future expenditures required for environmental matters could increase in the future. In addition, any major upgrades in any of our refineries could require material additional expenditures to comply with environmental laws and regulations.

We believe that we have sufficient funds from operations and, to the extent necessary, from borrowings under our credit facilities, to fund our ongoing operating requirements. We expect that, to the extent necessary, we can raise additional funds from time to time through equity or debt financings in the public and private capital markets or the arrangement of additional credit facilities. However, there can be no assurances regarding the availability of any future financings or additional credit facilities or whether such financings or additional credit facilities can be made available on terms that are acceptable to us.

***CRITICAL ACCOUNTING POLICIES***

The preparation of financial statements in accordance with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Our critical accounting policies are disclosed in our annual report on Form 10-K for the year ended December 31, 2008.

As discussed in Note 2 of Condensed Notes to Consolidated Financial Statements, certain new financial accounting pronouncements have been issued that either have already been reflected in the accompanying consolidated financial statements, or will become effective for our financial statements at various dates in the future.

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk*****COMMODITY PRICE RISK***

For information regarding gains and losses on our derivative instruments, see Note 10 of Condensed Notes to Consolidated Financial Statements. The following tables provide information about our derivative commodity instruments as of March 31, 2009 and December 31, 2008 (dollars in millions, except for the weighted-average pay and receive prices as described below), including:

**Fair Value Hedges** Fair value hedges are used to hedge certain recognized refining inventories (which had a carrying amount of \$4.4 billion as of both March 31, 2009 and December 31, 2008, and a fair value of \$5.5 billion and \$5.1 billion as of March 31, 2009 and December 31, 2008, respectively) and our unrecognized firm commitments (*i.e.*, binding agreements to purchase inventories in the future). The gain or loss on a derivative instrument designated and qualifying as a fair value hedge and the offsetting loss or gain on the hedged item are recognized currently in income in the same period.

**Cash Flow Hedges** Cash flow hedges are used to hedge certain forecasted feedstock and product purchases, refined product sales, and natural gas purchases. The effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedge is initially reported as a component of other comprehensive income and is then recorded in income in the period or periods during which the hedged forecasted transaction affects income. The ineffective portion of the gain or loss on the cash flow derivative instrument, if any, is recognized in income as incurred.

**Economic Hedges** Economic hedges are hedges not designated as fair value or cash flow hedges that are used to:

- manage price volatility in refinery feedstock and refined product inventories;
- manage price volatility in forecasted feedstock and product purchases, refined product sales, and natural gas purchases; and
- manage price volatility in the referenced product margins associated with the three-year earn-out agreement with Alon in connection with the sale of our Krotz Springs Refinery.

The derivative instruments related to economic hedges are recorded at fair value and changes in the fair value of the derivative instruments are recognized currently in income.

**Trading Activities** These represent derivative commodity instruments held or issued for trading purposes. The derivative instruments entered into by us for trading activities are recorded at fair value and changes in the fair value of the derivative instruments are recognized currently in income.

The following tables include only open positions at the end of the reporting period. Contract volumes are presented in thousands of barrels (for crude oil and refined products) or in billions of British thermal units (for natural gas). The weighted-average pay and receive prices represent amounts per barrel (for crude oil and refined products) or amounts per million British thermal units (for natural gas). Volumes shown for swaps represent notional volumes, which are used to calculate amounts due under the agreements. For futures, the contract value represents the contract price of either the long or short position multiplied by the derivative contract volume, while the market value amount represents the period-end market price of the commodity being hedged multiplied by the derivative contract volume. The pre-tax fair value for futures, swaps, and options represents the fair value of the derivative contract. The pre-tax fair value for swaps represents the excess of the receive price over the pay price multiplied by the notional contract volumes. For futures and options, the pre-tax fair value represents (i) the excess of the market value amount over the contract amount for long positions, or (ii) the excess of the contract amount over the market value amount for short positions. Additionally, for futures and options, the weighted-average pay price represents the contract price for long positions and the weighted-average receive price represents the contract price for short positions. The weighted-average pay price and weighted-average receive price for options represents their strike price.

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	<b>March 31, 2009</b>					
	<b>Contract Volumes</b>	<b>Wtd Avg Pay Price</b>	<b>Wtd Avg Receive Price</b>	<b>Contract Value</b>	<b>Market Value</b>	<b>Pre-tax Fair Value</b>
<b>Fair Value Hedges:</b>						
<b>Futures short:</b>						
2009 (crude oil and refined products)	7,267	N/A	\$ 51.82	\$ 377	\$ 368	\$ 9
<b>Cash Flow Hedges:</b>						
<b>Swaps long:</b>						
2009 (crude oil and refined products)	20,802	113.37	56.13	N/A	(1,191)	(1,191)
2010 (crude oil and refined products)	15,900	60.46	62.67	N/A	35	35
<b>Swaps short:</b>						
2009 (crude oil and refined products)	20,802	61.03	130.04	N/A	1,436	1,436
2010 (crude oil and refined products)	15,900	71.00	72.68	N/A	27	27
<b>Futures long:</b>						
2009 (crude oil and refined products)	1,238	53.45	N/A	66	55	(11)
<b>Economic Hedges:</b>						
<b>Swaps long:</b>						
2009 (crude oil and refined products)	46,937	45.24	28.44	N/A	(789)	(789)
2010 (crude oil and refined products)	27,764	86.47	56.96	N/A	(819)	(819)
2011 (crude oil and refined products)	3,900	124.78	66.76	N/A	(226)	(226)
<b>Swaps short:</b>						
2009 (crude oil and refined products)	38,153	38.44	63.06	N/A	939	939
2010 (crude oil and refined products)	27,918	62.75	99.19	N/A	1,017	1,017
2011 (crude oil and refined products)	3,900	72.53	136.66	N/A	250	250
<b>Futures long:</b>						
2009 (crude oil and refined products)	300,779	54.23	N/A	16,312	16,344	32
2010 (crude oil and refined products)	27,086	63.93	N/A	1,732	1,804	72
<b>Futures short:</b>						
2009 (crude oil and refined products)	297,998	N/A	56.34	16,789	16,627	162
2010 (crude oil and refined products)	27,416	N/A	66.87	1,833	1,890	(57)
<b>Options long:</b>						
2009 (crude oil and refined products)	13	59.75	N/A			
<b>Trading Activities:</b>						
<b>Swaps long:</b>						
2009 (crude oil and refined products)	14,482	73.81	44.90	N/A	(419)	(419)
2010 (crude oil and refined products)	14,610	31.35	28.97	N/A	(35)	(35)
2011 (crude oil and refined products)	1,950	78.36	68.58	N/A	(19)	(19)
<b>Swaps short:</b>						
2009 (crude oil and refined products)	13,905	46.95	78.52	N/A	439	439
2010 (crude oil and refined products)	9,609	44.36	51.11	N/A	65	65
2011 (crude oil and refined products)	1,950	68.87	80.59	N/A	23	23
<b>Futures long:</b>						

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2009 (crude oil and refined products)	21,809	71.91	N/A	1,568	1,220	(348)
2010 (crude oil and refined products)	1,411	75.85	N/A	107	96	(11)
2009 (natural gas)	100	4.18	N/A			

**Futures short:**

2009 (crude oil and refined products)	21,784	N/A	72.14	1,571	1,221	350
2010 (crude oil and refined products)	1,411	N/A	75.56	107	96	11
2009 (natural gas)	100	N/A	4.31			

**Total pre-tax fair value of open positions** \$ 942



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	Contract Volumes	December 31, 2008		Contract Value	Market Value	Pre-tax Fair Value
		Wtd Avg Pay Price	Wtd Avg Receive Price			
<b>Fair Value Hedges:</b>						
<b>Futures short:</b>						
2009 (crude oil and refined products)	6,904	N/A	\$ 48.28	\$ 333	\$ 320	\$ 13
<b>Cash Flow Hedges:</b>						
<b>Swaps long:</b>						
2009 (crude oil and refined products)	60,162	\$ 121.69	58.44	N/A	(3,805)	(3,805)
2010 (crude oil and refined products)	4,680	63.72	64.03	N/A	1	1
<b>Swaps short:</b>						
2009 (crude oil and refined products)	60,162	62.38	129.80	N/A	4,056	4,056
2010 (crude oil and refined products)	4,680	76.32	78.69	N/A	11	11
<b>Futures long:</b>						
2009 (crude oil and refined products)	780	38.62	N/A	30	27	(3)
<b>Economic Hedges:</b>						
<b>Swaps long:</b>						
2009 (crude oil and refined products)	25,987	96.88	55.25	N/A	(1,082)	(1,082)
2010 (crude oil and refined products)	19,734	105.96	63.94	N/A	(829)	(829)
2011 (crude oil and refined products)	3,900	124.78	67.99	N/A	(221)	(221)
<b>Swaps short:</b>						
2009 (crude oil and refined products)	25,931	59.65	106.81	N/A	1,223	1,223
2010 (crude oil and refined products)	19,734	72.18	121.96	N/A	982	982
2011 (crude oil and refined products)	3,900	74.08	136.66	N/A	244	244
<b>Futures long:</b>						
2009 (crude oil and refined products)	135,882	59.17	N/A	8,040	7,319	(721)
2010 (crude oil and refined products)	3,466	78.33	N/A	271	240	(31)
2009 (natural gas)	4,310	8.46	N/A	36	24	(12)
<b>Futures short:</b>						
2009 (crude oil and refined products)	135,091	N/A	62.74	8,475	7,510	965
2010 (crude oil and refined products)	3,692	N/A	84.66	313	276	37
2009 (natural gas)	4,310	N/A	5.68	24	24	
<b>Options long:</b>						
2009 (crude oil and refined products)	57	60.64	N/A	1		(1)
<b>Trading Activities:</b>						
<b>Swaps long:</b>						
2009 (crude oil and refined products)	19,887	77.56	45.09	N/A	(646)	(646)
2010 (crude oil and refined products)	10,050	40.66	35.35	N/A	(53)	(53)
2011 (crude oil and refined products)	1,950	78.36	65.80	N/A	(24)	(24)
<b>Swaps short:</b>						
2009 (crude oil and refined products)	16,084	56.44	97.17	N/A	655	655
2010 (crude oil and refined products)	5,850	64.19	73.12	N/A	52	52
2011 (crude oil and refined products)	1,950	68.06	80.59	N/A	24	24



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	<b>December 31, 2008</b>					
	<b>Contract</b>	<b>Wtd</b>	<b>Wtd</b>	<b>Contract</b>	<b>Market</b>	<b>Pre-tax</b>
	<b>Volumes</b>	<b>Avg</b>	<b>Avg</b>	<b>Value</b>	<b>Value</b>	<b>Fair</b>
		<b>Pay</b>	<b>Receive</b>			<b>Value</b>
		<b>Price</b>	<b>Price</b>			
<b>Futures long:</b>						
2009 (crude oil and refined products)	24,039	\$ 71.70	N/A	\$ 1,724	\$ 1,300	\$ (424)
2010 (crude oil and refined products)	956	84.12	N/A	80	70	(10)
2009 (natural gas)	200	5.79	N/A	1	1	
<b>Futures short:</b>						
2009 (crude oil and refined products)	21,999	N/A	\$ 73.38	1,614	1,209	405
2010 (crude oil and refined products)	956	N/A	83.63	80	70	10
2009 (natural gas)	200	N/A	5.82	1	1	
<b>Options long:</b>						
2009 (crude oil and refined products)	100	30.00	N/A			
<b>Total pre-tax fair value of open positions</b>						<b>\$ 816</b>

**Table of Contents****INTEREST RATE RISK**

The following table provides information about our debt instruments (dollars in millions), the fair value of which is sensitive to changes in interest rates. Principal cash flows and related weighted-average interest rates by expected maturity dates are presented. We had no interest rate derivative instruments outstanding as of March 31, 2009 and December 31, 2008.

	March 31, 2009						Total	Fair Value
	Expected Maturity Dates							
	2009	2010	2011	2012	2013	There-after		
<b>Debt:</b>								
Fixed rate	\$ 209	\$ 33	\$ 418	\$ 759	\$ 489	\$ 5,597	\$ 7,505	\$ 7,554
Average interest rate	3.6%	6.8%	6.4%	6.9%	5.5%	7.3%	7.0%	
Floating rate	\$ 100	\$	\$	\$	\$	\$	\$ 100	\$ 100
Average interest rate	2.6%	%	%	%	%	%	2.6%	

	December 31, 2008						Total	Fair Value
	Expected Maturity Dates							
	2009	2010	2011	2012	2013	There-after		
<b>Debt:</b>								
Fixed rate	\$ 209	\$ 33	\$ 418	\$ 759	\$ 489	\$ 4,597	\$ 6,505	\$ 6,362
Average interest rate	3.6%	6.8%	6.4%	6.9%	5.5%	6.8%	6.6%	
Floating rate	\$ 100	\$	\$	\$	\$	\$	\$ 100	\$ 100
Average interest rate	3.9%	%	%	%	%	%	3.9%	

**FOREIGN CURRENCY RISK**

As of March 31, 2009, we had commitments to purchase \$106 million of U.S. dollars. Our market risk was minimal on these contracts, as they matured on or before April 24, 2009, resulting in a \$3 million loss in the second quarter of 2009.

**Item 4. Controls and Procedures**

(a) *Evaluation of disclosure controls and procedures.*

Our management has evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report, and has concluded that our disclosure controls and procedures were effective as of March 31, 2009.

(b) *Changes in internal control over financial reporting.*

There has been no change in our internal control over financial reporting that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

The information below describes new proceedings or material developments in proceedings that we previously reported in our annual report on Form 10-K for the year ended December 31, 2008.

**Litigation**

For the legal proceedings listed below, we hereby incorporate by reference into this Item our disclosures made in Part I, Item 1 of this Report included in Note 13 of Condensed Notes to Consolidated Financial Statements under the caption *Litigation*.

*MTBE Litigation*

*Retail Fuel Temperature Litigation*

*Rosolowski*

*Other Litigation*

**Environmental Enforcement Matters**

While it is not possible to predict the outcome of the following environmental proceedings, if any one or more of them were decided against us, we believe that there would be no material effect on our consolidated financial position or results of operations. We are reporting these proceedings to comply with SEC regulations, which require us to disclose certain information about proceedings arising under federal, state, or local provisions regulating the discharge of materials into the environment or protecting the environment if we reasonably believe that such proceedings will result in monetary sanctions of \$100,000 or more.

*Bay Area Air Quality Management District (BAAQMD)* (Benicia Refinery). In our Form 10-K for the year ended December 31, 2008, we reported that from 2006 to 2008, the BAAQMD had issued 86 violation notices (VNs) for various alleged air regulation and air permit violations at our Benicia Refinery and asphalt plant. We recently settled 36 of these VNs with the BAAQMD.

*New Jersey Department of Environmental Protection (NJDEP)* (Paulsboro Refinery). In the first quarter of 2009, the NJDEP issued two Administrative Order and Notice of Civil Administrative Penalty Assessments (Notices) to our Paulsboro Refinery. The first alleges excess air emissions at the refinery for the third quarter of 2008, and assesses a penalty of \$338,800. The other assesses a penalty of \$278,800 relating to alleged Title V permit deviations. We are pursuing settlement of these Notices.

*Oklahoma Department of Environmental Quality (ODEQ)* (Ardmore Refinery). In the first quarter of 2009, we settled a penalty demand from the ODEQ relating to alleged excess air emission violations from 2006 to 2008 at our Ardmore Refinery.

*Texas Commission on Environmental Quality (TCEQ)* (McKee Refinery). In the first quarter of 2009, we settled a proposed Agreed Order from the TCEQ to resolve nine alleged violations of air regulations at our McKee Refinery.

**Item 1A. Risk Factors**

There have been no material changes from the risk factors disclosed in the *Risk Factors* section of our annual report on Form 10-K for the year ended December 31, 2008.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(a) *Unregistered Sales of Equity Securities.* Not applicable.

(b) *Use of Proceeds.* Not applicable.

(c) *Issuer Purchases of Equity Securities.* The following table discloses purchases of shares of our common stock made by us or on our behalf for the periods shown below.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Not Purchased as Part of Publicly Announced Plans or Programs (1)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (at month end)
January 2009	500	\$ 23.31	500		\$ 3.46 billion
February 2009	4,032	\$ 22.83	4,032		\$ 3.46 billion
March 2009	4,496	\$ 17.77	4,496		\$ 3.46 billion
Total	9,028	\$ 20.34	9,028		\$ 3.46 billion

- (1) The shares reported in this column represent purchases settled in the first quarter of 2009 relating to (a) our purchases of shares in open-market transactions to meet our obligations under employee benefit plans, and (b) our purchases of shares from our employees and non-employee directors in connection with the exercise of stock options, the vesting of restricted stock, and other stock compensation transactions in accordance with the terms of our incentive compensation plans.
- (2) On April 26, 2007, we publicly announced an increase in our common stock purchase program from \$2 billion to \$6 billion, as authorized by our board of directors on April 25, 2007. The \$6 billion common stock purchase program has no expiration date. On February 28, 2008, we announced that our board of directors approved a new \$3 billion common stock purchase program. This program is in addition to the \$6 billion program. This \$3 billion program has no expiration date.

**Item 6. Exhibits**

<u>Exhibit No.</u>	<u>Description</u>
*12.01	Statements of Computations of Ratios of Earnings to Fixed Charges and Ratios of Earnings to Fixed Charges and Preferred Stock Dividends.
*31.01	Rule 13a-14(a) Certification (under Section 302 of the Sarbanes-Oxley Act of 2002) of principal executive officer.
*31.02	Rule 13a-14(a) Certification (under Section 302 of the Sarbanes-Oxley Act of 2002) of principal financial officer.
*32.01	

Section 1350 Certifications (as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002).

\* Filed herewith.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**VALERO ENERGY CORPORATION**  
(Registrant)

By: /s/ Michael S. Ciskowski  
Michael S. Ciskowski  
Executive Vice President and  
Chief Financial Officer  
(Duly Authorized Officer and Principal  
Financial and Accounting Officer)

Date: May 7, 2009