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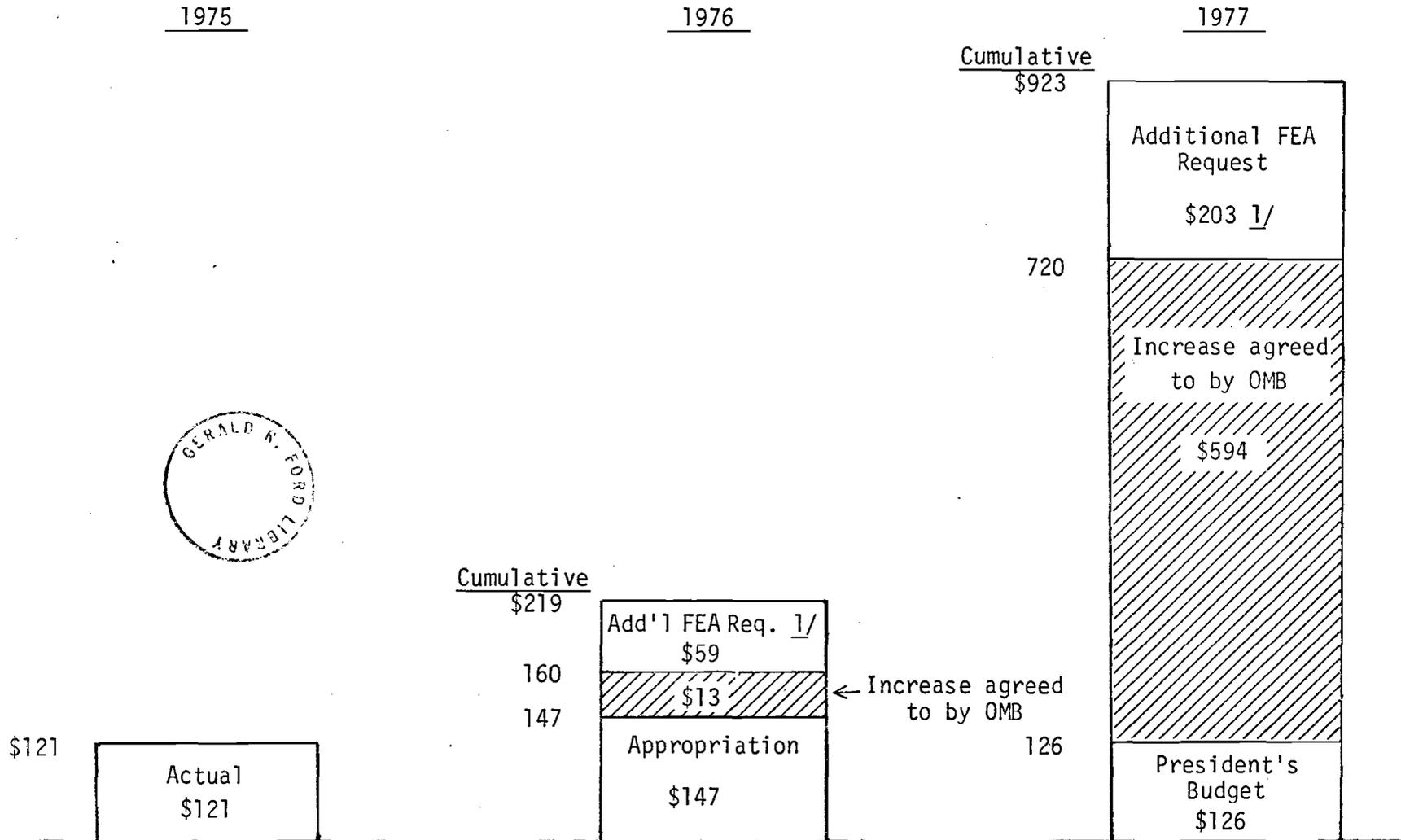
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SUMMARY OF RESOURCES

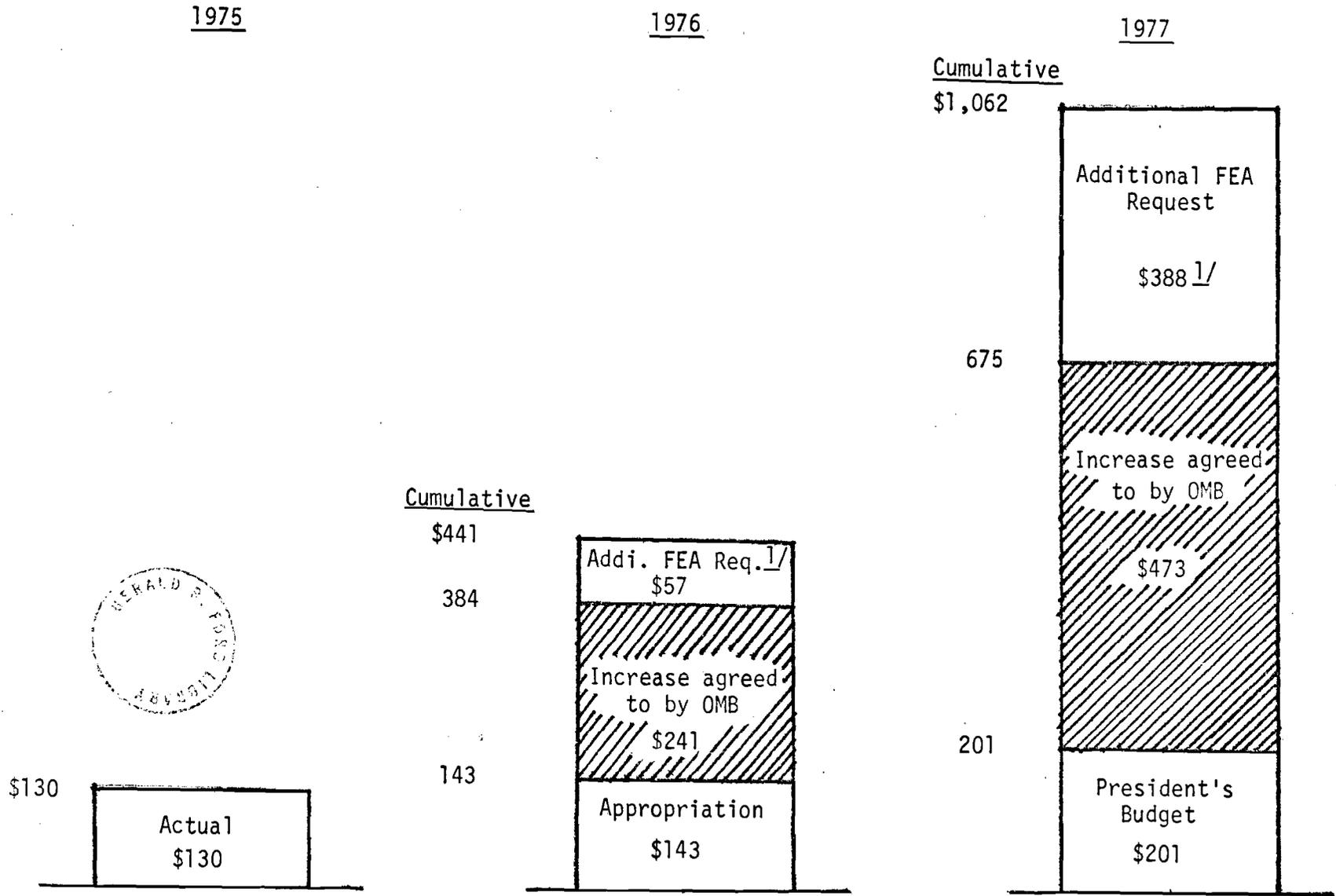
FEA Outlays - Summary
(in \$ millions)

3/23/76



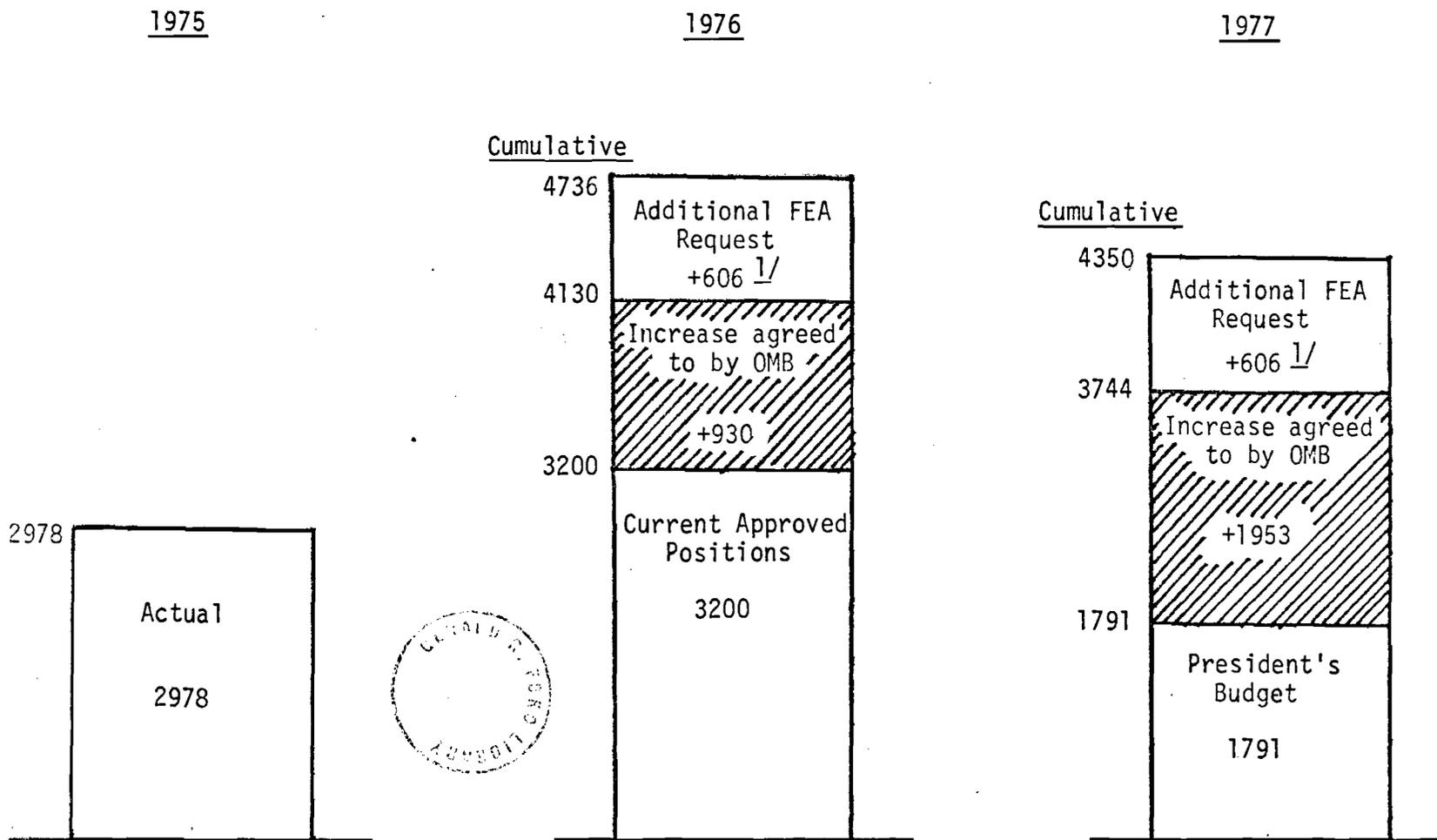
1/ Most of this amount is for the Strategic Petroleum Reserve Program

FEA Budget Authority - Summary
(in \$ millions)



^{1/2} Most of this amount is for the Strategic Petroleum Reserve Program

FEA Employment Summary
(end-of-year permanent positions)



^{1/} All of the additional positions requested are for the petroleum industry audit and compliance program, including necessary support.

Federal Energy Administration
1976 and 1977 Budget

Summary Data

	(In Millions)		Employment, End-of-Year	
	<u>Budget Authority</u>	<u>Outlays</u>	<u>Full-Time Permanent</u>	<u>Total</u>
1975 actual	130.0	120.7	2978	3245
1976 Enacted	143.0	147.4	3200	3200
Supplemental requested (total)	441.3	219.3	4736	4736
OMB recommendation	383.9	160.1	4130	4130
TQ Enacted	25.3	14.7	xx	xx
Supplemental requested (total)	44.1	133.1	xx	xx
OMB recommendation	44.1	43.4	xx	xx
1977 January budget	201.3	126.0	1791	1791
Amendment requested (total)	1062.1	922.9	4350	4350
OMB recommendation	674.6	720.1	3744	3744



BUDGET ISSUES -
Tab I - State Grants

Issue Paper *
Federal Energy Administration
1976 Budget Supplemental and 1977 Budget Amendment
Issue I: State Energy Conservation Grants

Statement of Issue:

What approach should be followed for the State energy conservation grant program?

Background

- Energy Policy and Conservation Act (EPCA):
 - . Assumes that higher energy prices and numerous new Federal regulations -- including automobile fuel economy, appliance labeling, and industrial energy conservation -- will not conserve enough energy.
 - . Assumes that States can take actions to help solve the national energy problem, and encourages States to implement programs to save energy. The goal is a 5% or more reduction in the total energy consumption predicted for each participating State in 1980 to result from the State grant program. If the goal is met in all States, energy consumption would increase by about 6% from 1975 to 1980, rather than the 11% currently predicted.
 - . Provides Federal financial and technical support through a new categorical grant program to States to plan and implement energy conservation programs; authorizes \$150 million (\$50 million/year) over 3 years beginning in FY 1976 for these activities.
- This grant program was not part of the President's energy program, and the Administration did not support this program during the legislative process.
- EPCA invites but does not require States to participate with energy conservation programs.
- EPCA requires that those States choosing to participate will plan to implement 5 mandatory conservation programs to be eligible for Federal assistance; and authorizes other discretionary conservation programs which the States may propose as part of their overall State energy conservation plans.

* Joint issue paper by OMB -- FEA



- To implement the 5 mandatory programs, a participating State would:
 - . Promulgate mandatory standards for lighting in non-Federal public buildings.
 - . Promulgate energy-related mandatory standards which State and local governments must follow when making purchases of goods and services.
 - . Promulgate mandatory insulation requirements for new and renovated buildings.
 - . Enact a "right-turn-on-red-light" traffic law, consistent with safety.
 - . Develop programs to promote the use of carpools, vanpools, and public transportation.
(Note that this overlaps EPA/DOT planning grant programs which encourage carpools, vanpools, bus lanes, fringe parking to augment public transportation, etc. EPA grants \$55 million/year, UMTA \$45 million/year, FHWA \$125 million/year.)
- Discretionary programs are authorized by EPCA:
 - . Restrictions governing the hours and conditions of operating public buildings;
 - . Restrictions on the use of decorative or nonessential lighting;
 - . Transportation controls;
 - . Public education programs;
 - . Other appropriate programs to conserve energy.
- FEA presented in their budget justification a list of illustrative programs of this type eligible for Federal grant assistance which included:
 - . Stricter enforcement of 55 mph speed limit by increasing number of police officers;
 - . Mailing energy conservation questionnaires to every home;
 - . Providing technical assistance to small businesses;
 - . Promoting changes in State laws to increase the taxes on gasoline.



- Both FEA and OMB agree on funding level of \$7.2 million (including \$5 million planning grants) in 1976 and \$50 million (including \$45 million implementation grants) in 1977. FEA and OMB also agree to limit funds to the planning, coordination, and promotion of energy conservation programs. There would be no funding of demonstration projects or equipment. Funds would be appropriated on an annual basis, and would lapse at the end of the fiscal year if not obligated.
- FEA and OMB disagree about the basic program approach that should be followed in implementing the program.

Alternatives

- #1. Allocate grants to States on basis of cost effectiveness of specific program measures, energy saved, and people affected. Provide flexibility to FEA and States in selecting either mandatory or discretionary programs. (FEA)
- #2. Allocate grants to States by simple formula based on share of national population and/or energy consumption. Place most emphasis on implementation of mandatory programs. (OMB)



Comparison of Alternatives

Structuring
Implementation Grants

Alternative #1 (FEA)

Alternative #2 (OMB)

A. Treatment of EPCA mandatory and discretionary programs

Allow funding of programs developed by States with major energy savings potential. Do not mandate all required programs to be implemented prior to funding of discretionary programs since passage of State laws to implement all these programs prior to first year grant awards would be very difficult to achieve.

Direct 80% of FY 1977 funds toward the 5 mandatory programs. Funding for planning mandatory programs can take place before State legislatures take action. After all the mandatory programs are satisfactorily implemented and operational, the remaining 20% plus any unused funds left from the 80% allotment for mandatory programs could be used for discretionary programs.

B. Method of determining allocations to States

Allotment based on the contribution to energy conservation which can reasonably be expected and the number of people affected.

All funds allocated by formula using concrete measure based on State population and/or State energy consumption. States required to meet guidelines before funds are released.

C. Flexibility to program available funds

Allow unused funds from one State to be reallocated to other States before the end of the fiscal year to prevent lapsing.

Unused funds from one State could not be reallocated to other States which already have their own allotments. Unused funds would lapse.



Analysis

Alternative #1. Allocate grants to States on basis of cost effectiveness of specific program measures, energy saved, and people affected. Provide flexibility to FEA and States in selecting either mandatory or discretionary programs. (FEA)

- Program structure is flexible; could maximize energy savings within authorized fundings.
- Advantages are:
 - . FEA and States allowed flexibility to select and approve, in their judgment, more energy efficient programs.
 - . Maximizes State participation.
 - . Follows one aspect of Congressional intent, which is that FEA consider in determining financial assistance "the contribution to energy conservation which can reasonably be expected."
- Disadvantages are:
 - . Emphasis on discretionary programs will lead to funding of numerous activities. This could create State interest in expanding and perpetuating FEA grant program.
 - . Flexibility could allow most funds to be granted to a few States with aggressive energy offices, so that remaining States create pressure for expanding grant amounts by arguing "equal sharing."



Alternative #2. Allocate grants to States by simple formula using population. Place most emphasis on implementation of mandatory programs. (OMB)

- Program structure is important and needs to be decided now -- it will drive future-year funding and the scope of the type of programs funded at the State level. This is a new categorical grant program with a broad charter that could be used to fund a broad range of State needs. A flexible program would threaten to become permanent and expensive.
- Advantages are:
 - . Focuses effort on Congressional EPCA priorities -- 5 mandatory programs.
 - . Limits pressure for continuing/expanding this grant program in future years.
 - . Minimizes complexity and cost of program administration because discretionary programs limited. Large staff in FEA and States would not be required to develop, evaluate and approve discretionary program proposals.
- Disadvantages are:
 - . Some States may not participate because they don't want to implement the mandatory program.
 - . May conflict with Congressional and State desires for more emphasis on flexible grant program for energy conservation.



Tab II - Compliance

Issue Paper *
 Federal Energy Administration
 1976 Budget Supplemental and 1977 Budget Amendment
 Issue II: Compliance Program (under EPCA)

Statement of Issue

What should be the staffing level of the FEA compliance program in 1976 and 1977 now that the Energy Policy and Conservation Act has extended price controls?

Position Summary (by audit program area including support personnel)

	<u>1976 End-of-Year Positions</u>				<u>1977 End-of-Year Positions</u>			
	<u>Current Base</u>	<u>FEA Request</u>	<u>% incr.</u>	<u>OMB Recom.</u>	<u>Current Base¹</u>	<u>FEA Request</u>	<u>OMB Recom.</u>	
Crude Producers	186	451	142	336	0	451	336	Tab A
Major Refiners	209	374	79	337	0	374	337	Tab B
Small Refiners	107	107	--	52	0	107	52	Tab C
Natural Gas Liquid Plants	70	151	116	99	0	151	99	Tab D
Wholesalers	288	333	16	208	0	333	208	
(propane only)	--	(161)	--	(36)	0	(161)	(36)	Tab E
(other than propane)	--	(172)	--	(172)	0	(172)	(172)	
Retailers	69	154	123	95	0	154	95	
(propane only)	--	(122)	--	(63)	0	(122)	(63)	Tab F
(other than propane)	--	(32)	--	(32)	0	(32)	(32)	
Importers	--	27	--	19	0	27	19	Tab G
Gatherers	--	26	--	18	0	26	18	Tab H
Headquarters Staff	<u>134</u>	<u>226</u>	<u>69</u>	<u>162</u>	<u>0</u>	<u>226</u>	<u>162</u>	Tab I
Total Direct Compliance Positions	1063	1849	74	1326	0	1849	1326	
Indirect Support for Compliance	<u>326</u>	<u>587</u>	<u>80</u>	<u>517</u>	<u>0</u>	<u>587</u>	<u>517</u>	
Total Compliance-Related Positions	1389	2436	75	1843	0	2436	1843	
Total Increase over Current Base	--	+1047	--	+454	-	+2436	+1843	



¹assumed phaseout of price controls * Joint issue paper by OMB -- FEA

Background

- FEA's current FY 1976 appropriation was based on the expiration of controls on November 15, 1975, and assumed that FEA would need a regional staff of auditors and investigators to complete the backlog of audits of petroleum firms over 15½ months. FY 1976 staff level approved for this wrap-up program was 929.
- FEA's FY 1976 budget supplemental and FY 1977 amendment request would increase the size of the current regional compliance staff by 75%, from 929 to 1623, and the Washington, D.C. headquarters regulatory staff by 69%, from 134 to 226.
- It is FEA's view that enactment of EPCA has fundamentally changed the nature of the compliance effort, from one where the regulatory authority would expire completely on a certain date, to one where an audit program would continue over a period of 40 months.
- OMB assessment of the EPCA is that it makes compliance audits somewhat more complex (because of changed price rules and new base period production control levels), but that an increase of 75% in the regional compliance staff overstates FEA's need for new auditors under EPCA. OMB would recommend a regional staff increase of 25%.
- Key factors involved in determining FEA's regional audit staff requirements are:
 - (1) Audit Coverage -- the percentage of firms and petroleum production to be audited annually.
 - . FEA proposes a new auditing strategy which would permit it to audit those firms accounting for 80% of the annual production every two years and the remaining 20% every five years. FEA's objective was to spend most time on large firms in which larger violations are probable, while at the same time covering smaller firms sufficient to assure a reasonable level of compliance.
 - . OMB generally agrees that audit coverage should emphasize the larger firms accounting for most production with sufficient coverage of smaller firms to promote compliance. OMB disagrees with the extent of coverage proposed for audit by FEA when (1) FEA

coverages exceed those used by the Internal Revenue Service in tax audits, and (2) when coverages are too high on smaller firms accounting for only a small portion of total production and where the potential for uncovering significant price violations is limited.

- . FEA believes that comparisons with IRS coverages are misleading because FEA's program is only two years old, expires in 40 months, and is not nearly as fully developed as IRS's system. By comparison, IRS's program is over 50 years old and is a permanent program. OMB, on the other hand, believes that IRS's long experience in maintaining the integrity of the Nation's tax system in economic-type audits regarding targeting of violators, determining audit coverage levels necessary to insure compliance, and use of self-reporting forms is a valid indication of the level of coverage needed. The fact that IRS has only four full-time auditors of Exxon is relevant to program credibility in OMB's view.

(2) Audit Times -- the number of work weeks or staff years required to conduct an audit of a firm.

- . FEA proposes to increase audit times by an average of 90% over 1976 approved levels. The basis for these estimates takes into account: (1) EPCA requires more complex rules, (2) a proposed switch from conducting limited wrap-up audits on the basis of complaints received to normal full-scale audits, (3) newly developed audit guidelines which require more audit time, and (4) adjustments for productivity increases resulting from management improvements.
- . It is OMB's view that new EPCA requirements will moderately, not dramatically, increase time required per audit (20-30% on the average).

OMB has tended to rely on audit time estimates prepared by FEA's 10 regional offices in January, 1976. These estimates were developed by FEA regions with specific national headquarters instructions to consider the impact of new EPCA requirements on staff and budget resource needs for each audit sector.

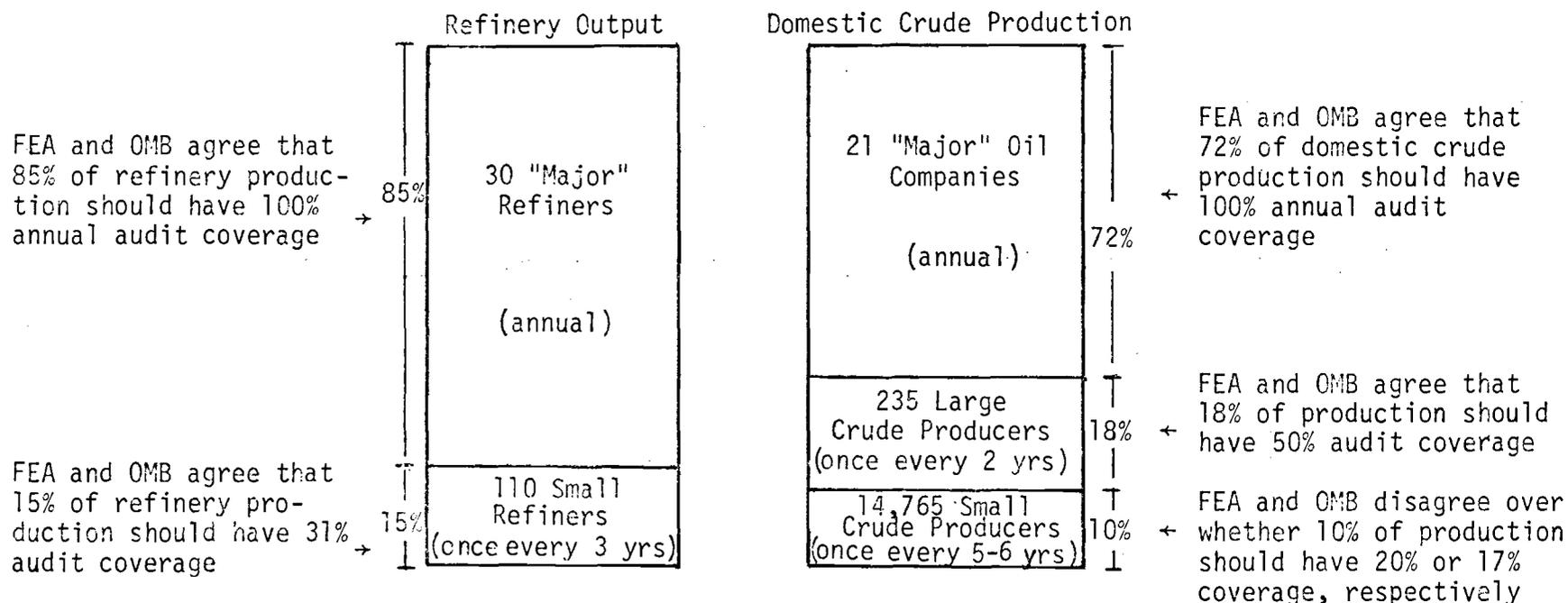
- . FEA contends that the data provided by FEA's ten regional offices generally supported its budget justification (except for small refiners and propane resellers); OMB disagrees.
- . In addition, OMB would apply a 10% productivity improvement factor to audit times because: (1) FEA's audit program in many audit sectors is still at an early development stage, (2) an increasing number of audits in 1976 and 1977 will be repeat audits of the same firm which should reduce audit time, and (3) FEA will be able to streamline its auditing approach over the next several months, e.g., through greater use of self-reporting forms, and (4) the "learning curve" of auditors relatively inexperienced in new audit areas will improve faster than normal. General OMB policy is to apply annual productivity adjustments of up to 2.5% for stable, ongoing functions. However, in most of its petroleum audits, FEA is in an early phase (with the exception of the wholesale and retail sectors).

- . FEA believes that its audit time estimates already consider expected management improvements (e.g., use of sampling and improved audit guidelines) and that productivity improvements (e.g., less time to do repeat audits and more experienced auditors) will not have an impact until FY 1978. It is OMB's view that productivity gains will come during the remainder of FY 1976 and in FY 1977.
- Because it is important that the FEA compliance effort be credible, it is OMB's view that the following comparisons of employment in other Federal economic regulatory agencies are useful to keep in mind:
 - . Federal Power Commission (Natural gas, hydroelectric, and interstate wholesale power regulation) -- total agency positions: 1320
 - . Civil Aeronautics Board (Domestic and international air carrier regulation) -- total agency positions: 720
 - . Interstate Commerce Commission (Regulation of surface transportation) -- total agency positions: 2050
 - . Securities and Exchange Commission (Regulation of securities markets, holding companies, and investment companies) -- total agency positions: 1935 positions
 - . Federal Home Loan Bank Board (Regulation of savings and loan associations) -- total agency positions: 1360
 - . Cost of Living Council (Price and wage controls over U.S. economy) -- total agency positions during FY 1974 and 1975: 950, plus an Internal Revenue Service compliance force of 2700 positions
- FEA believes that attempts to compare its staffing requirements with other regulatory agencies are specious due to FEA's unique situation. In that connection, FEA cites examples of other agencies that have larger regulatory staffs than FEA, e.g., Bureau of Mines with 5000 mines and 1500 mine safety inspectors.



Analysis

- There is little disagreement between FEA and OMB on the extent to which audit resources should be applied to audit coverage of "big oil," i.e., major refiners, and major and large independent crude producers. This part of the industry, which is most subject to public skepticism, accounts for 90% of crude oil production and 85% of refinery output.



- OMB and FEA disagree over the time that would be required to complete audits in these sectors.
- TABS A through H that follow treat separately those audit sectors where FEA and OMB disagree over audit times and audit coverage. In some cases, FEA and OMB disagree over only one of the factors, while in others, both factors are still in dispute. The final TAB (TAB I) deals with personnel requirements of the Headquarters compliance staff that supports and oversees the regional compliance program.



TAB A -- Independent Crude Producers

	<u>% Annual Audit Coverage</u>	<u>No. of Producers</u>	<u>= No. of Audits</u>	<u>Average Time Per Audit (Work Weeks)</u>	<u>= Total Staff Years</u>
Current 1976 Appropriation*	18.0%	15,000	2700	3.1	186
FEA Request (Ait. #1)	20.4%	15,000	3100	6.2	451
OMB Recommendation (Ait. #2)	18.0%	15,000	2700	5.3	336
(IRS Coverage)	(16.5%)				

115 staff year difference

* consistent with Presidential decisions in FY 1977 budget

Areas of Difference

- % Annual audit coverage: 20.4% coverage (FEA), 18% coverage (OMB), 16.5% coverage (IRS)

. Implications of difference: 49 end-of-year positions
\$177,500 in FY 1976 and \$1.42 million in FY 1977

. Source of difference: FEA and OMB agree that the 235 largest crude producers should be audited every two years (50% coverage). However, there is disagreement over the audit cycle to be applied to the remaining 14,765 smaller independent producers. FEA maintains a 5-year cycle (20% coverage annually) should be used because the program will last only 49 months. OMB recommends a 6-year cycle in line with the IRS tax audit coverages applied to oil and gas producers in the same asset range.

- Average time per audit: 6.2 work weeks (FEA) vs. 5.3 work weeks (OMB)

. Implications of difference: 66 end-of-year positions
\$241,000 in FY 1976 and \$1.93 million in FY 1977

. Source of difference: FEA does not agree with OMB's application of 10% productivity factor to audit times, indicating that further improvements are not possible in FY 1976 and FY 1977. Use of the factor reduces FEA's requested audit time from 6.2 to 5.3 work weeks. FEA contends that it already considered a productivity factor in earlier time estimates.

As indicated earlier, OMB review of the January, 1976 regional estimates and the supplemental/amendment budget justification did not reveal use of such a factor. Further, it is OMB's view that since the crude producer program is still in early stages of implementation, it is reasonable to expect a 10% improvement in productivity time.

14 of the 66 positions in dispute are related to an FEA-OMB difference over the audit times required for the largest 235 crude producers. FEA estimate for these audits is 18.5 work weeks and is based on a selected sample of 20 recently completed crude producer audits in 2 regions. FEA believes that the 18.5 work week figure based on completed audits is more representative than OMB's estimate of 13.2 work weeks. OMB, however, points out that the 13.2 work week estimate is not based on a valid sample of audits because: (1) they involved a higher than normal percentage of violations (violations take more time to audit) and (2) the sample of 20 audits were among the first to be completed in the crude producer sector (later audits should take less time).



TAB B -- Major Refiners

	%	No. of	No. of	Average Time		Total Staff Years
	Annual	Refiners	Audits	Per Audit	=	
	Audit Coverage			(Staff Years)	=	
Current 1976 Appropriation*	77%	30	23	9.00		209
FEA Request (Alt. #1)	100%	30	30	12.47		374
OMB Recommendation (Alt. #2)	100%	30	30	11.22		337

} 37 staff year
} difference

* consistent with Presidential decisions in FY 1977 budget

Area of Difference

- Average time per audit: 12.47 staff years (FEA) vs. 11.22 staff years (OMB)

. Implications of difference: 37 end-of-year positions
\$124,000 in FY 1976 and \$.99 million in FY 1977

. Source of difference: Only disagreement is over application of 10% productivity factor to FEA's audit time request (see earlier remarks -- p. 3 and 4). By comparison, IRS has only four tax auditors at Exxon.



TAB C -- Small Refiners

	<u>% Annual Audit Coverage</u>	<u>No. of Refiners</u>	<u>No. of Audits</u>	<u>Average Time Per Audit (Staff Years)</u>	<u>Total Staff Years</u>
Current 1976 Appropriation*	32%	110	35	3.05	107
FEA Request (Alt. #1)	31%	110	34	3.15	107
OMB Recommendation (Alt. #2)	31%	110	34	1.52	52

} 55 staff year
} difference

* consistent with Presidential decisions in FY 1977 budget

Area of Difference

- Average time per audit: 3.15 of a staff year (FEA) vs. 1.52 of a staff year (OMB)

. Implications of difference: 55 end-of-year positions
\$184,000 in FY 1976 and \$1.47 million in FY 1977

. Source of difference: FEA's case time is based on the actual audit time of a small refiner (Husky -- one of the 5 largest small refiners of the universe of 110). This refinery was used because the audit was recently completed, covered a representative audit period, and included a review of all applicable regulations. FEA has very little experience in full audits of small refiners. Using the Husky case time, FEA stratified its case time estimates into 3 categories but contends that audit workloads do not decrease in proportion to volume. FEA feels its use of an actual case time is more logical than using the January 1976 regional estimates.

OMB recommendation is based on a 1.52 staff year per audit weighted average estimate as submitted by all 10 FEA regions in January 1976. These estimates include all small refiners audited by FEA. It is OMB's view that the use of a "first-time" audit rate for one refiner (Husky) is not a valid basis on which to develop estimates for 110 refiners who are smaller in size. Stratified time estimates for the second and the third categories of small refiners were not reduced proportionally by FEA to decreases in refinery volume levels. Based upon this approach, FEA's estimate of average audit time is 3.15 staff years per audit. OMB believes the regional estimates are more representative of audit times.



TAB D -- Natural Gas Liquid Plants

	<u>% Annual Audit Coverage</u>	<u>No. of Plants</u>	<u>No. of Audits</u>	<u>Average Time Per Audit (Work Weeks)</u>	<u>Total Staff Years</u>
Current 1976 Appropriation*	29%	709	206	15.0	70
FEA Request (Alt. #1)	41%	709	289	23.3	151
OMB Recommendation (Alt. #2)	29%	709	206	21.1	99

52 staff year
99 } difference

* consistent with Presidential decisions in FY 1977 budget

Description: Natural gas as it comes from the ground contains significant volumes of natural gasoline, as well as natural gas liquids (NGL) including butane and propane (bottled gas). These same products are also produced in refineries, but are technically labelled liquefied petroleum gases (LPG). NGL and LPG are in fact the same fuels. LPG from refineries makes up 25% of total liquefied gas production. The basic technology employed in separating out natural gas liquids is similar to refining, but the average liquids output of the NGL plants is smaller than the typical small refinery.

Areas of Difference

- Audit Coverage: 41% coverage (FEA) vs. 29% coverage (OMB)

. Implications of difference: 42 end-of-year positions
\$141,000 in FY 1976 and \$1.13 million in FY 1977

. Source of difference: FEA maintains that 41% coverage of NGL plants is necessary to meet its internal target of auditing natural gas processors producing 80% of NGL plant volume every two years. FEA excluded in its NGL plant staffing estimate the 25% of liquefied petroleum gas produced in refineries.

OMB disagrees with this exclusion since the goal is to audit 80% of production (natural gas liquids in NGL plants and liquefied petroleum gases in refineries). FEA's exclusion would have been appropriate if all liquids were produced only by natural gas processors. In fact, however, 25% of liquefied petroleum gases (propane, butane, and isobutane) are produced by oil refineries, which are audited at an 80% coverage rate. Therefore, it is OMB's view that only 29% annual audit coverage is needed on the other 75% of production from gas processing plants to satisfy FEA's internal goal of auditing 80% of production every two years, since 25% of the liquids production is covered by refiner audits.

- Audit Times: 23.3 work weeks (FEA) vs. 21.1 work weeks (OMB)

. Implications of difference: 10 end-of-year positions
\$33,500 in FY 1976 and \$268,000 in FY 1977

. Source of difference: Only difference is over OMB's application of a 10% productivity factor (see earlier remarks -- p. 3 and 4). FEA has less experience auditing natural gas liquid plants than any other major sector in its auditing program. FEA only began auditing in the area in late 1975 and has not completed its first audit.

FEA disagrees with OMB approach indicating it already considered a productivity factor in earlier estimates and that productivity gains will not occur during the remaining months of FY 1976 or in FY 1977.



TAB E -- Propane Wholesalers

	<u>% Annual Audit Coverage</u>	<u>No. of Wholesalers</u>	<u>No. of Audits</u>	<u>Average Time Per Audit (Work Weeks)</u>	<u>Total Staff Years</u>
Current 1976 Appropriation*	--	--	--	--	--
FEA Request (Alt. #1)	28%	2000	560	13.2	161
OMB Recommendation (Alt. #2)	20%	2000	400	4.0	36
(IRS Coverage)	(18.5%)				

125 staff year difference

* propane wholesalers not previously treated as a separate audit sector apart from the broader "wholesaler" category

Description: Propane wholesalers include both brokers and dealers which operate terminals. Many of these firms conduct wholesale and retail business concurrently. In addition, many are brokerage-type operations whose physical facilities consist of a small office.

Areas of Difference

- Audit Coverage: 28% coverage (FEA), 20% coverage (OMB), 18.5% (IRS)

. Implications of difference: 18 end-of-year positions
\$60,000 in FY 1976 and \$482,000 in FY 1977

. Source of difference: FEA proposes that 28% of propane wholesalers be audited annually; this would permit auditing firms accounting for 80% of sales every two years and those smaller firms having 20% of propane sales every 5 years. OMB recommends 20% of propane wholesalers be audited annually, thereby allowing audits of 70% of sales every two years and the other 30% of sales every 6 years. OMB's recommended coverage is consistent with IRS coverages of wholesale businesses in comparable asset ranges. FEA contends that coverage recommended by OMB is totally unacceptable from a public perception standpoint in this sensitive propane area.

Over the 40-month control period, it is FEA's view that the probability a propane wholesaler (in the universe of 2000) would be audited under FEA's strategy is 75%; under OMB's recommended approach it is OMB's view that the probability of audit would be 60%.

- Audit Times: 13.2 work weeks (FEA) vs. 4.0 work weeks (OMB)

. Implications of difference: 107 end-of-year positions
\$252,000 in FY 1976 and \$2.87 million in FY 1977

. Source of difference: FEA request of 13.2 work weeks based on a selected sample of audit times for completed wholesaler cases in the Dallas, Kansas City, and Seattle regions.

OMB recommendation based on audit time estimates prepared in January, 1976 by FEA's Dallas and Kansas City regional offices, which handle 80% of all propane wholesalers. That same January, 1976 report showed that the weighted average for all 10 regions was 4.4 work weeks per audit. It is OMB's view that FEA's sample case times on audits taken from the start-up phase of its propane audit program are not valid indicators of how long it will take to do subsequent audits in FY 1976 and FY 1977 because they do not take account of time savings that would occur in repeat audits or improvements from having more experienced FEA auditors.

FEA contends that cases chosen for audit during the start-up phase of this program were not as complex as audits to be performed later. They were, in effect, training audits that were easier to conduct. Further, it is FEA's view that improvements in their targeting system (enabling better identification of probable violators), will result in higher audit times, since it takes longer to audit a violator.



TAB F -- Propane Retailers

	<u>% Annual Audit Coverage</u>	<u>No. of Retailers</u>	<u>= No. of Audits</u>	<u>Average Time Per Audit (Work Weeks)</u>	<u>= Total Staff Years</u>
Current 1976 Appropriation*	--	--	--	--	--
FEA Request (Alt. #1)	28%	8000	2200	2.5	122
OMB Recommendation (Alt. #2) (IRS Coverage)	14% (13.8%)	8000	1120	2.5	63

} 59 staff year difference

* propane retailers not previously treated as a separate sector apart from the broader "retailer" category

Description: The typical retailing installation is a small operation with a single office, a couple of storage tanks, and one to a half-dozen trucks. There are some national chains with numerous retail outlets, but most firms operate a single outlet operation. 90% of the firms do less than \$500,000 in sales (annually), and have 5 employees or less.

Area of Difference

- Audit Coverage: 28% coverage (FEA), 14% coverage (OMB), 13.8% coverage (IRS)

. Implications of difference: 59 end-of-year positions
\$204,000 in FY 1976 and \$1.63 million in FY 1977

. Source of difference: FEA proposes that 28% of propane retailers be audited annually, permitting coverage of firms accounting for 80% of sales every two years and coverage of smaller retailers having 20% of propane sales every 5 years. OMB recommends 14% coverage allowing audits of 70% of sales every two years and the other 30% of sales on a 10-year cycle. OMB's recommended coverage is in line with IRS coverages of retail businesses in comparable asset ranges.

Over the 40-month control period, it is FEA's view that the probability that a propane retailer (in the universe of 8000) would be audited under FEA's strategy is 75%; under OMB's approach, OMB's view is that the probability of audit would be 40%.



TAB G -- Importers

	<u>% Annual Audit Coverage</u>	<u>No. of Importers</u>	<u>No. of Audits</u>	<u>Average Time Per Audit (Work Weeks)</u>	<u>Total Staff Years</u>
Current 1976 Appropriation	--	--	--	--	--
FEA Request (Alt. #1)	28%	598	167	7	27
OMB Recommendation (Alt. #2)	20%	598	120	7	19

8 staff year
difference

Area of Difference

- Audit Coverage: 28% coverage (FEA) vs. 20% coverage (OMB)

. Implications of difference: 8 positions
\$27,000 in FY 1976 and \$214,000 in FY 1977

. Source of difference: OMB recommendation would maintain a 5-year audit cycle, in line with coverage allowed for propane wholesalers, which have a similar broker function.

FEA contends that OMB approach would mean that the percentage of importers subject to audit is too low. Over the 40-month control period, it is FEA's view that the probability that an importer (in the universe of 598) would be audited under the FEA strategy would be 75%; under the OMB approach, OMB concludes the probability would be 47%.

It is OMB's view that 47% probability of audit will be adequate to deter importer violations, and that as FEA gains experience in this new audit sector, that time per audit will decrease below 7 work weeks per audit, thereby allowing FEA greater than 20% coverage.



TAB H -- Gatherers

	<u>% Annual Audit Coverage</u>	<u>×</u>	<u>No. of Gatherers</u>	<u>=</u>	<u>No. of Audits</u>	<u>×</u>	<u>Average Time Per Audit (Work Weeks)</u>	<u>=</u>	<u>Total Staff Years</u>
Current 1976 Appropriation	--		--		--		--		--
FEA Request (Alt. #1)	28%		200		56		20		26
OMB Recommendation (Alt. #2)	20%		200		40		20		18
									8 staff year difference

This sector consists of firms that collect crude oil by tank truck, barge tanker, or pipeline. Gatherers take title to the oil they transport, and sell this oil to buyers.

Area of Difference

- % Annual audit coverage: 28% coverage (FEA) vs. 20% coverage (OMB)

. Implications of difference: 8 end-of-year positions
\$27,000 in FY 1976 and \$214,000 in FY 1977

. Source of difference: FEA disagrees with the OMB approach of 20% coverage, contending that it does not provide sufficient resources for re-audits of firms. They contend some probability of re-audit is needed to deter those firms audited at the beginning of the program from subsequently violating FEA regulations.

Over the 40-month control period, the probability that a gatherer (in the universe of 200) would be audited under FEA's proposed strategy is 77%; under OMB's approach the probability would be 67%. In addition, under OMB's plan, 1/3 of the major gatherers could be targeted for repeat audits.

OMB recommendation is consistent with audit coverage applied to the wholesaler/broker functions for propane and importers. As FEA gains experience in this area, it will no longer take twenty weeks to complete an audit, thus allowing broader audit coverage with available staff.



TAB I -- Headquarters Compliance Staff

	(Staff Years)		Ratio of HQ Staff to Regional Compliance Staff
	<u>1976</u>	<u>1977</u>	
Current Base	134	0	1:6.9 (FY 1976 only)
FEA Request	226	226	1:7.2
OMB Recommendation	162	162	1:7.2

- FEA request of 226 headquarters positions is in addition to their request of 1623 positions for field compliance auditing.
- OMB believes there is a sufficient relationship between functions performed by headquarters and field compliance activities to warrant using an overall constant headquarters:field ratio to determine the staffing requirements for the headquarters.
- FEA accepts the use of such ratios to determine that portion of its headquarters staffing that it believes to be involved with the management and support of regional operations, but does not agree that the method can be applied to a sizable portion of its headquarters compliance staff. FEA contends that this portion performs functions (e.g. planning, policy development, development of training and audit guidelines, etc.) that are not directly related to the size of its regional staff. Specifically, FEA identifies 115 positions in that category. There are currently 44 employees assigned against this "fixed" requirement of 115 positions. FEA contends that the only way it has performed these functions with 44 employees has been through greater use of contractors and overtime--practices which they say cannot continue indefinitely.
- FEA contends that the reason only 44 positions are now assigned to these functions is that current staffing is inadequate. In FEA's opinion, this inadequate staffing has contributed substantially to the many criticisms (from the public, the GAO, and the Congress) regarding FEA's management of its compliance program.
- OMB recommends an increase of 21% in positions (from a current base of 134 to 162). In addition, it is OMB's view that FEA will have sufficient contract funds through the end of FY 1976 to continue work identified as fixed overhead. Specifically, OMB has recommended that an additional \$.5 million in contract funds be allowed for development of computerized audit packages and targeting systems, for preparation of new sections of the compliance manual, and for expanded compliance training. The peak for resource requirements in these activities will be in the second half of FY 1976 (in the six months following the signing of the EPCA); after that period, activity on development of targeting approaches or in writing new sections of the compliance manual will level off. OMB notes that FEA's request for 115 positions in the fixed overhead category would involve an increase of 161% over its current assigned strength of 44, and that an increase of this magnitude is difficult to justify when the field compliance staff is increasing by only 25% under OMB's view, or 75% under FEA's view. In short,

OMB concludes that, while some of the functions identified by FEA in the fixed overhead category may not be directly related to the size of the field compliance staff, in the aggregate, there is a definite relationship between field size and headquarters staffing needs. Therefore, OMB recommends an overall 1:7.2 ratio be applied to FEA's field compliance strength.



TAB III - Strategic
Petroleum Reserve
FEA Proposal



FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

OFFICE OF THE ADMINISTRATOR

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB

SUBJECT: Strategic Petroleum Reserve Issues

Although the energy debate of 1975 was marked by considerable controversy, the one area of solid agreement with the Congress was the need for a strategic reserve that could be used to soften the impact of an embargo and act as a deterrent to the possible imposition of an embargo. Differences with the Congress in this area centered not around the desirability of a strategic reserve, but around the structure and timing of the reserve.

The Energy Policy and Conservation Act contains your strategic storage program with several modifications:

- The act authorizes the 1 billion barrel reserve contained in your program, but places greater emphasis on a reserve of only a half of billion barrels.
- The emphasis on a smaller reserve in the early years is balanced off by statutory requirements that the one-half billion system be in place within seven years and that 150 million barrels be in place in three years. In short, the Congress opted for a smaller reserve within a definite time frame as opposed to a larger reserve with an open-ended schedule, while agreeing to additional storage up to your 1 billion level if the additional storage is judged to be necessary after seven years.
- As a result of pressure from the New England delegation, the act also mandates the storage of product in different regions of the country unless it can be demonstrated that large scale crude storage systems in the Gulf (which are dramatically cheaper than the steel tank storage that would have to be constructed for the regional reserves) can supply products in a timely manner in the event of an embargo.





- Finally, the act provides the authority you requested to require industry to shoulder the financial cost of the oil placed in the reserve, but limits the obligation to approximately 180 million barrels.

FEA has conducted comprehensive studies over the past 15 months regarding implementation of the strategic reserve and has reached the following conclusions regarding the above modifications to your current program:

- The seven and three year system requirements not only can be met, but also should be met. The latter judgment is based on the fact that meeting the schedules (as opposed to stretching out the system's development) will be dramatically cheaper in budgetary terms, have less environmental problems, and provides an opportunity to begin near-term discussions with selected OPEC countries regarding the possibility of bulk purchases of crude oil at below market prices.
- A strong case can be made that the more expensive regional storage is both unnecessary vis-a-vis the requirements of the Act and overly costly, even though there will be considerable political opposition.
- Steps should be taken to begin implementation of the requirement to have industry absorb all of the oil costs provided in the bill, even though there will be considerable opposition from the industry.

OMB is not in agreement with FEA's position regarding the schedule for meeting the three year statutory requirement of 150 million barrels. They would go for a stretched out schedule on grounds that the longer schedule will enable FEA to save \$78 million in facilities costs, even though the OMB approach will cost \$265-400 million more than the FEA plan when the cost of purchasing the oil is included in the budget calculation.

OMB does agree with FEA's position on the regional storage system and the industrial reserve, but would defer announcing these decisions until a later time. FEA is required to submit a report to the Congress on the 150 million barrel program by March 22, and believes that tentative decisions on these issues must be included in the report.

Apart from these issues, which are addressed in the attachments, FEA, OMB and Interior are not in agreement on the price FEA ought to pay for oil for the strategic storage system:

- . OMB recommends that FEA allocate old oil (\$5.25) to the system as the lowest cost option;
- . FEA recommends a combination of royalty oil and oil purchased at the domestic average price;
- . Interior objects to the use of royalty oil.

In FEA's view, its position is not only a valid compromise between the extremes of old oil and world oil prices (it would have the government paying slightly less than the price paid for crude by the oil industry), but also roughly equivalent to the price we would anticipate paying to OPEC producers if a below market bulk purchase price can be arranged. The OMB option would preclude any efforts to negotiate such arrangements.

The issue here, which is addressed in greater detail in the attachments, is what price to pay for the oil, not how to finance the purchase of oil. As you know, production from the Naval Petroleum Reserves will finance the purchases over time.

I believe that FEA has carefully analyzed the strategic reserve program and has developed a program that will not only meet the time requirements in the Act, but also fully optimize the system at the least cost. I am prepared to discuss these issues with you and other advisors at your earliest possible convenience.

Attachments .



ISSUE 1: SCHEDULE FOR ESTABLISHING THE RESERVE

Issue and Discussion

The Energy Policy and Conservation Act requires FEA to store 150 million barrels of petroleum within 3 years, and to submit a report to Congress by March 21, 1976, describing plans for construction and fill of the Early Storage Reserve (ESR). Although all your advisors agreed with your program to establish a strategic reserve, there is no longer unanimity on scheduling because of perceived cost differences. Some favor a slower program than that which FEA believes is required by law and feasible to attain.

OMB prefers a slower approach with slightly lower facilities costs. Because FEA cost estimates show that acquisition of existing mines would cost more than the construction of new cavities in salt domes, OMB argues that FEA should:

- o Effectively exclude mines and new salt domes on the basis of marginal costs; and
- o Utilize only four salt domes with existing caverns and expand them by leaching new caverns.

FEA plans an early storage system using a mix of existing mines and salt dome cavities. New caverns can be expanded at these sites if technically feasible, or new salt domes would be utilized to increase the storage capacity of the total Reserve. FEA's plan is based on factors that FEA considers to be decisive. FEA's plan:

- o Is the only way to meet the three-year schedule (and thereby comply with Congressional intent as expressed in the Act);
- o Will, in fact, save \$265 to \$400 million compared to OMB's "go slow" approach because oil purchased during the period of price control will be significantly less costly than after controls expire and, further, oil purchased during the early control period is less costly than oil purchased later in the period;
- o Will, by providing more storage capacity sooner, give us more flexibility in discussions with OPEC countries regarding bulk purchase of oil below market prices, as we have recently discussed in context of Iranian and Russian deals;



- 4. Allocate old oil to the Government and buy it at \$5.25 per barrel.

OMB prefers this option, but FEA opposes it. This is the least costly option as it would cost \$640,000,000. This option would meet the greatest industry and congressional opposition as it was not anticipated that FEA would use regulatory programs to allocate cheap oil to itself.

FEA's Office of the General Counsel advises that legal challenge to this approach would not be frivolous and would pose a substantial risk of an adverse decision. This option carries considerable risk in that if allocation of cheap old oil to the Government is overturned in court (1) the opportunity to take royalty oil may be lost if old contracts are renewed, and (2) the opportunity to negotiate a bulk purchase at reduced cost with a foreign country would no longer be available because the appropriated funds at \$5.25 per barrel would be insufficient for such a bulk purchase.

Decision

- Option 1 _____ Concur
- Option 2 _____ Concur
- Option 3 _____ Concur
(FEA recommended option)
- Option 4 _____ Concur
(OMB recommended option)



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* NEW PAGE BEING REVISED BY FEA

ISSUE 2: SOURCE AND PRICE OF STORED OIL

Issue and Discussion

The Government is required to purchase oil for the Early Storage Reserve (ESR). Four options have been considered.

1. Buy imported oil at the world market price.

This option is the most costly of all the options. It would require appropriation of \$1,634,000,000*. It would put the full social cost of the Government portion of the petroleum in the Reserve on the Federal budget.

2. Buy domestic or imported oil at the national average cost through participation in the Entitlements Program.

This is the next highest cost alternatives to the Federal Government and would cost \$1,309,000,000. The Government would be buying oil on the same basis as other purchasers, and this option could be defended politically as the most equitable. However, it misses the opportunity of passing much of the cost of the program to the beneficiaries of it.

3. Store the royalty oil now taken in kind by the Government and sold to small refiners and obtain the additional oil needed in the open market at the national average price through participation in the Entitlements Program.

This is the second least costly alternative and the one preferred by FEA. It would cost \$231,000,000. The Department of the Interior (DOI) strongly opposes diversion of royalty oil from the small refiners because they believe it would create a financial burden for the small refiners. However, according to DOI, royalty oil accounts for only 1/4 of the crude supply of the 38 small refineries. In fact, DOI plans to reduce individual refiners' benefits under this program by extending eligibility from 38 to 69 refineries. This would lessen the share of each participant in the current program. Denial of royalty oil to these refineries would not eliminate their source of supply as they presently exchange such oil for that actually run in their refineries. If it is deemed necessary, to subsidize some or all of these "small" refiners in the near-term, FEA's regulatory program can be adjusted to reflect a small industry bias.



* Cost estimates assume Government purchase of 95 million barrels, i.e., utilization of the Industrial Petroleum Reserve for 55 million barrels of the ESR.

4. Allocate old oil to the Government and buy it at \$5.25 per barrel.

OMB prefers this option, but FEA opposes it. This is the least costly option as it would cost \$640,000,000. This option would meet the greatest industry and congressional opposition as it was not anticipated that FEA would use regulatory programs to allocate cheap oil to itself.

FEA's Office of the General Counsel advises that legal challenge to this approach would not be frivolous and would pose a substantial risk of an adverse decision. This option carries considerable risk in that if allocation of cheap old oil to the Government is overturned in court (1) the opportunity to take royalty oil may be lost result in a cost of \$286 million more than FEA's preferred alternative, and (2) the opportunity to negotiate a bulk purchase at reduced cost with a foreign country would no longer be available because the appropriated funds at \$5.25 per barrel would be insufficient for such a bulk purchase.

Decision

Option 1 _____ Concur

Option 2 _____ Concur

Option 3 _____ Concur
(FEA recommended option)

Option 4 _____ Concur
(OMB recommended option)



ISSUE 3: INDUSTRIAL PETROLEUM RESERVE

Issue and Discussion

The Energy Policy and Conservation Act gives FEA discretion to establish an Industrial Petroleum Reserve (IPR) as part of the Early Storage Reserve (ESR) and/or the Strategic Petroleum Reserve (SPR).

- o FEA may require industry to acquire and store, in readily accessible inventories, oil equal to 3 percent of the total imported or refined in the previous calendar year (approximately 180 million barrels). Industry's prorated share of the 150 million barrel ESR, comparing 180 million barrels to 500 million barrels for the full SPR, would be 55 million barrels.

This provision was included in your proposals to Congress, and we strongly supported it in a letter to Senator Jackson, which he used to great effect in the Senate debates.

The ESR Report must contain plans to store 150 million barrels in 3 years. Therefore, the Report must describe:

- o Industry's portion of the Reserve, or
- o That funds for Government purchase of 150 million barrels will be needed.

FEA plans to announce in the ESR Report to Congress that:

- o IPR will be implemented and industry will be allowed to pass through the costs thereof;
- o Final decision on the IPR is subject to further consideration under procedures listed in the ESR;
- o The Government will budget for the purchase of 95 million barrels;
- o No appropriations will be requested for the portion of the Reserve to be provided by industry (55 million barrels).

FEA's plan would:

- o Put the cost of the storage program on the users of oil and the industry, i.e., those who will benefit during supply interruption;



- o Reduce Federal outlays by \$677 million for the ESR; and
- o Increase our flexibility by discussing the IPR in the current ESR Report (the ESR can be implemented without congressional approval whereas the SPR plan is subject to congressional review and disapproval).

On the other hand, OMB seeks to make no decision at this time and delete the entire IPR discussion from the ESR Report, and to delay decision until the December report to Congress. This would require us to:

- o Budget for the Government to purchase the entire 150 million barrels for the ESR; and
- o Secure congressional approval before we can implement the IPR.

Comment

- o All line agencies, including Treasury, agreed with FEA's proposal on the IPR or made no comment.
- o While industry can be expected to object to maximum utilization of the IPR, its complaints should be mitigated by pass through of costs and allowing industry to use low-cost United States Government storage facilities.

Decision

FEA Plan _____

OMB Plan _____



ISSUE 4: REGIONAL STORAGE

Issue and Discussion

The Energy Policy and Conservation Act requires that the Early Storage Reserve (ESR) meet the needs for residual fuel and refined products in regions which depend upon imports for a substantial portion of their total energy requirements. The Regional Petroleum Reserve section of the Act allows FEA to substitute crude oil or other petroleum products for amounts of residual or other refined petroleum products stored in the region, if there is no delay or other adverse effect on satisfying the regions interruption. The only reasonable means to store in the regions would be in steel tanks, however, storage costs for tanks are \$8 to \$12 per barrel while underground storage costs are \$1.40 per barrel. By fully utilizing our option to use substitutable central storage, we can hold costs for a 500 million barrel program to \$700 million; if we use steel tank storage in the regions, program costs will rise to \$2 billion.

Initial analysis indicates that the import product requirements of the Regions can be met by a combination of the measures listed below, at a significantly lower cost than physical storage within regions while still providing the level of regional protection required.

- o Substitution of crude for product, to supply Caribbean and domestic refineries, which could be stored underground in the Gulf Coast.
- o Conservation.
- o Emergency increase in refinery utilization.
- o Refinery yield shifts.

Since present analysis indicates that we can meet east coast needs for products during an interruption by storing crude oil in Gulf Coast salt domes and mines, we recommend not planning at this time to store refined products locally to meet the Regional Storage requirements. If further analysis indicates that small quantities of local storage may be needed, a recommendation will be made in the Strategic Reserve Plan report in December 1976.

Senator Kennedy, and other members of the New England delegations, have already voiced objections to our proposal not to use tanks. They argue that:

- o They will not have a cushion to offset inaccuracy in the analysis.
- o Seasonal peaks and contingencies are not provided for.
- o Shipping may not be available and a waiver to the Jones Act will be required.

We have examined the shipping requirements and, based on information supplied by the Maritime Administration, have concluded that, for embargoes of two million barrels a day or less, a Jones Act waiver would not be required. However, in the event of a severe embargo of four million barrels a day, a carefully limited waiver to the Jones Act would probably be needed whether or not we had total storage of products in the New England region.

New England would probably be satisfied at this time by the storage of a nominal amount of oil. Senator Kennedy's staff has proposed using surplus Government tank farms on the east coast for product storage pending completion of a definitive analysis. We have three such tank farms totalling about two million barrels. However, storage of products in the United States Government facilities at this stage would set a precedent that may be irreversible, even if subsequent analysis shows it is not needed. Accordingly, our recommendation is that we not plan for any tank storage at this time.

Recommendation

Because of the costs involved FEA feels that regional storage requirements can be met through the substitution of crude which would be stored underground in the Gulf Coast for refined products.

All agencies reviewing this issue either agreed with the FEA position or had no comment. OMB concurred with FEA.

Decision

Concur _____

Non-concur _____



TAB III - Strategic
Petroleum Reserve
OMB Proposal 1

3/22/76

Issue Paper
Federal Energy Administration
1976 Budget Supplemental and 1977 Budget Amendment
Issue III: Strategic Petroleum Storage

Statement of General Issue

How should the Federal Government proceed to implement the Strategic Petroleum Storage System?

Background

- The President's strategic petroleum storage proposal provided for:
 - . up to 1 billion barrels of stored oil, assuming low cost bulk storage facilities
 - . development over a flexible time frame of 10-15 years
 - . funded from the proceeds (\$ & oil) of production from Naval Petroleum Reserves 1, 2, 3 and 4
 - . flexible authority to require the private sector to store oil
- The Energy Policy and Conservation Act (EPCA), while similar in concept to the President's proposal, differs in that EPCA:
 - . Requires the storage of 150 million barrels of petroleum in 3-year "Early Storage Program"

The EPCA provides little flexibility on this requirement. Legal counsel advises that an attempt should be made to meet the requirement. If factors beyond the control of the Administrator occur, such as regulatory delays, strikes, adverse weather, law suits, etc., then a reasonable, legal basis for missing the target would exist.



- . Sets targets for the storage of 500 million barrels of petroleum in 7 years "Strategic Petroleum Reserve" with interim targets of:

18 months (June, 1977)	50 million barrels
36 months*	100 million barrels*
60 months	325 million barrels
72 months	500 million barrels

Flexibility is provided by EPCA on the targets. The Administrator is authorized to propose and justify changes to the time frames and volumes on the basis of all relevant factors, including "cost effectiveness, need to construct related facilities, and the ability to obtain sufficient quantities of petroleum to fill the facilities."

The Administration strongly opposed both the requirement for 150 million barrels of storage in 3 years and the 7-year and interim targets which were included in the EPCA by Congress.

- . Requires the FEA Administrator to:

- submit an implementation plan to Congress for the Early Storage Program by March 21. The plan, including any changes thereto, is not subject to congressional approval.
- submit a plan to Congress by December 21, 1976, for the Strategic Petroleum Reserve, which is subject to congressional disapproval. All changes to the plan are subject to congressional disapproval.

- . Authorizes FEA to require petroleum importers and refiners to store petroleum equal to 3% of the amount imported or refined by them in the preceding calendar year. At current levels up to 180 million barrels of petroleum could be required.



A strategic petroleum storage program:

- . will tend to boost the Nation's morale and self confidence, could serve as a deterrent to an embargo, could reduce pressure for more costly energy programs;

*The early storage program requirement of 3 years and 150 million barrels supersedes this target.

- . will increase imports, may reduce pressure on the cartel to cut prices, may not be used during an embargo. (Storage which existed in Europe was used to only a limited extent during the 1973/74 embargo.)

Economic analyses indicates the benefits of storage range from benefits about equal to its costs to significant net benefits.

- Legislation authorizing production from the Naval Petroleum Reserves:

- . has been agreed to by House/Senate conferees
- . will generate less oil and receipts than the President's original proposal since it:
 - authorizes production at Elk Hills for 6 years but not at NPR-4 in Alaska. (NPR-4 is transferred to Interior with a requirement to study NPR-4 development.)
 - contains a provision requiring purchasers using privately owned pipelines to make them available on a common carrier basis. This may complicate distribution of production, probably reducing deliverable crude in the 1976, 1977 time frame.

Shown below are estimates of receipts from NPR production available for storage after NPR production and development costs, and the amounts required for FEA's storage proposal designed to achieve the accelerated requirements of EPCA.

	<u>1976</u>	<u>1977</u>	<u>(\$ millions)</u> <u>1978-80</u>	<u>5-Year Total</u>
NPR receipts (available for storage)	\$ 23	\$126	\$2900	\$3055

- Issues pending Presidential decision include:

A. Time frame for implementing the storage program

What level of effort at what rate of development is necessary to attempt to meet:



- the 3-year requirement of 150 million barrels,
- the interim targets (see page 2), and
- the 7-year goal of 500 million barrels?

B. Cost, type, and number of storage facilities

What number and type of storage facilities (salt domes, mines) are necessary to implement the program in a cost effective manner in accordance with legislative requirements?

C. Industrial storage

Should the Administration propose on a tentative basis at this time to require importers and refiners to store up to 180 million barrels?

D. Price of oil for storage

What price should the government plan to pay for oil for storage?

E. Regional storage

Should quantities of petroleum be stored in regions of the country that are heavily dependent on imports? Both FEA and OMB agree that regional storage is not necessary because regional requirements can be met by storing crude much more cheaply in the Gulf Coast area and having it refined to meet any regional needs.

- FEA and OMB disagree on the first four issues (A-D).

The effect of these differences on outlays for FY 76 and TQ/77 is shown graphically on page 4a.

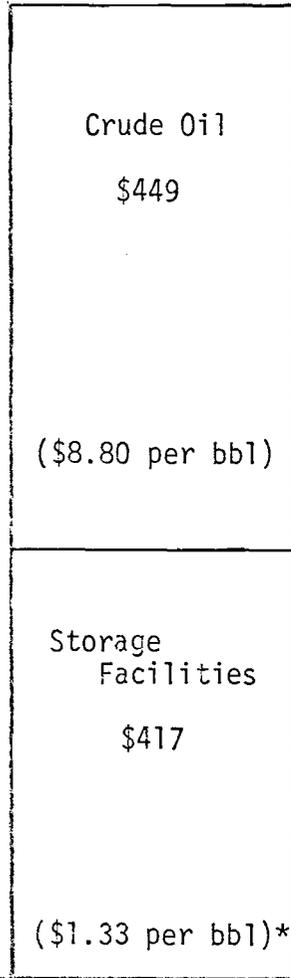


STRATEGIC PETROLEUM RESERVE FUNDING - 1976 & TQ/1977

(outlays in \$ millions)

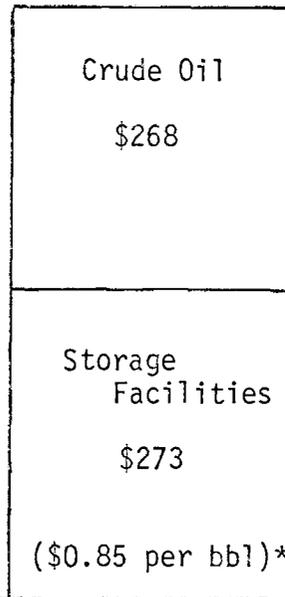
FEA REQUEST

Total \$866



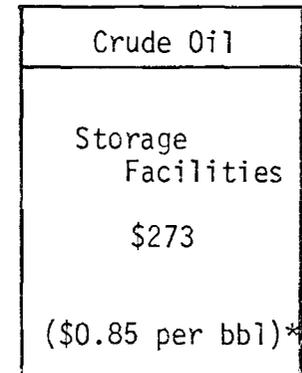
OMB (based on FEA schedule)

Total \$541



OMB (realistic)

Total \$278



← (\$5.25 per bbl) →



* average cost to design, purchase, and construct 500 million bbls of storage

COMPARISON - FEA AND OMB RECOMMENDATIONS
STRATEGIC STORAGE

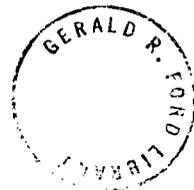
ISSUES	ALTERNATIVE 1 (FEA)	ALTERNATIVE 2 (OMB)
A. Implementation Schedule	<ul style="list-style-type: none"> ◦ Meet all requirements, make a <u>firm</u> commitment to meet: <ul style="list-style-type: none"> - 18-month target of 50 million barrels. - 3-year requirement for 150 million barrels of storage. 	<ul style="list-style-type: none"> ◦ Make a solid effort but no firm commitment that the 18-month target of 50 million barrels and 3-year requirement for 150 million barrels can be met. <u>1/</u>
B. Storage Facilities/Costs	<ul style="list-style-type: none"> ◦ Use existing domes, mines (9 sites) for early program, expand domes and use new sites to achieve 500 million barrels. ◦ Budget at \$1.33 per barrel or \$667 million for 1976 and 1977. 	<ul style="list-style-type: none"> ◦ Use smaller number of existing or new dome sites (5-7 sites), plan to expand sites for 500 million barrels. Mines would not be excluded if they can meet average per barrel cost of existing domes. ◦ Budget at \$0.85 per barrel or \$425 million for 1976 and 1977. ◦ Review in late 1976 once cost estimates are available and initial implementation is under way.
C. Industrial Storage	<ul style="list-style-type: none"> ◦ Make tentative commitment on 180 million barrels including 55 million for early storage program. 	<ul style="list-style-type: none"> ◦ Make no commitment at this time. ◦ Indicate study is needed and subsequent determination will be made.
D. Oil Pricing	<ul style="list-style-type: none"> ◦ Use royalty and mix of new/old domestic and imported oil at a cost of \$8.80 or \$450 million for 1976/1977. 	<ul style="list-style-type: none"> ◦ Use old domestic oil at \$5.25; don't specify source. Budget at \$290 million for 1976/1977.

1/ If more complete information shows that the target cannot be met in time without excessive expenditures, then legislative relief should be sought on the 3-year requirement.

A

ISSUE A Time frame for implementing the storage program

- The central problem with FEA's proposal is the philosophy that drives the program. FEA's philosophy is that 150 million barrels must be placed in storage within three years regardless of feasibility, risk or impairment to other sectors of the economy, because the EPCA requires a best effort to do so.
- OMB believes that:
 - . At the time that Congress included the 3-year, 150 million barrel requirement in EPCA, little engineering, economic or budgetary analysis had been done for the program.
 - . Information now available indicates that the requirement may not be feasible.
 - . Even if it is feasible at increased cost, we think it is in the interest of the nation as a whole to adopt an achievable schedule to reduce the program's cost and other adverse impacts.
- FEA argues that if the program can be implemented before price controls expire in May, 1979, then increased facility costs are offset by using cheap controlled oil which more than compensates for any extra cost for facilities.
- OMB disagrees and notes the following:
 - . Using FEA's schedule and the OMB recommendations, substantially the same results can be achieved in three years and four months, before price controls expire (May 1979), at lower overall cost than FEA's proposal.
 - . FEA estimates that \$667 million will be needed for facilities. This is \$242 million greater than OMB's estimate of \$425 which can achieve 150 million in an additional four months assuming FEA's schedule.
 - . FEA's proposed program results in outlays in excess of NPR receipts of \$738 million in 1976 and 1977, placing greater pressure on an already tight budget. (See graph, p. 6a.)
 - . FEA fails to include in its cost calculation costs incurred and impairment done elsewhere in the economy in its effort to accelerate the program.



(millions)
1300 •

Comparison - NPR Receipts vs. Outlays of Alternative Storage Programs

200 •

100 •

000 •

900 •

800 •

700 •

500 •

500 •

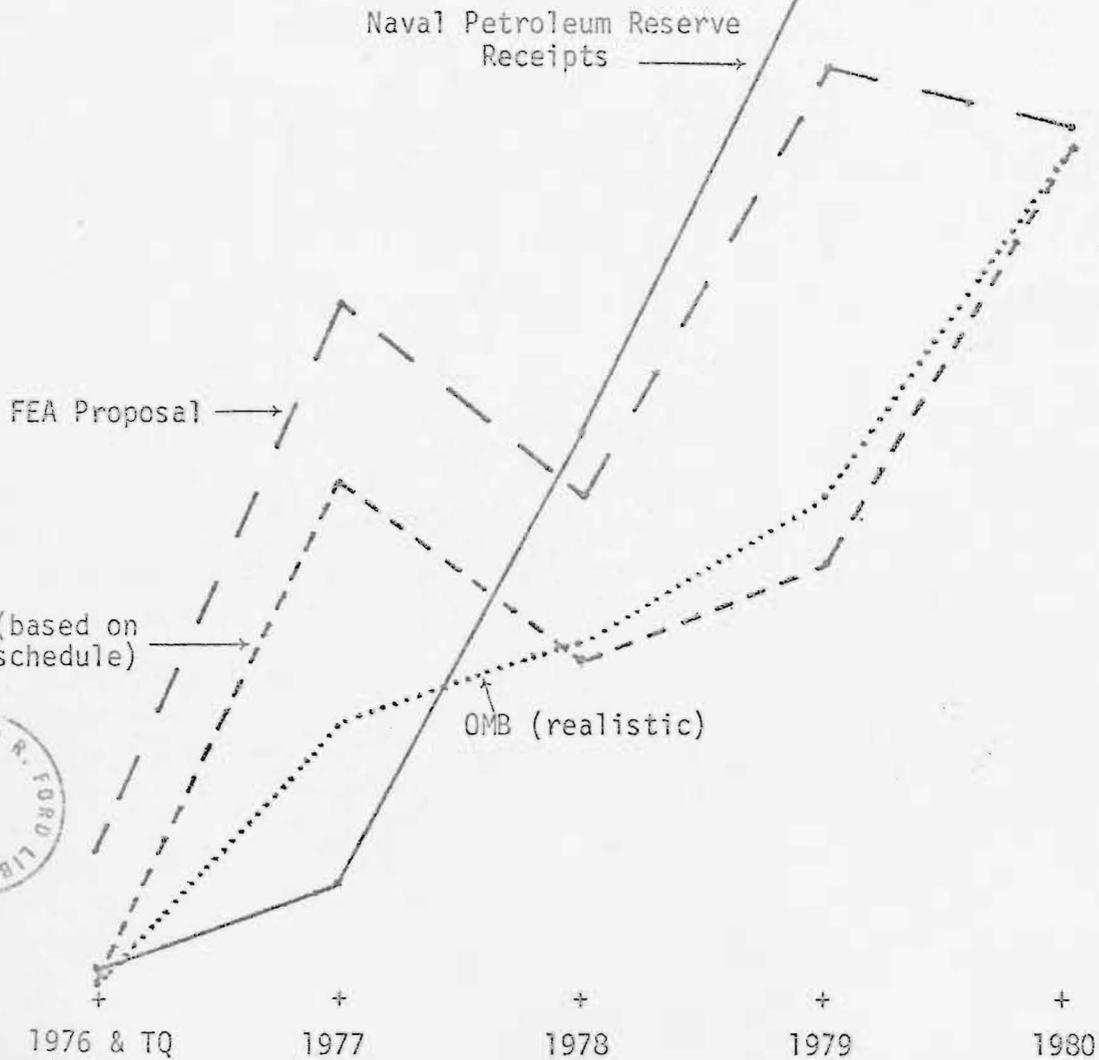
400 •

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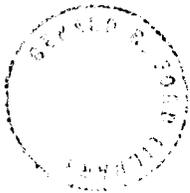
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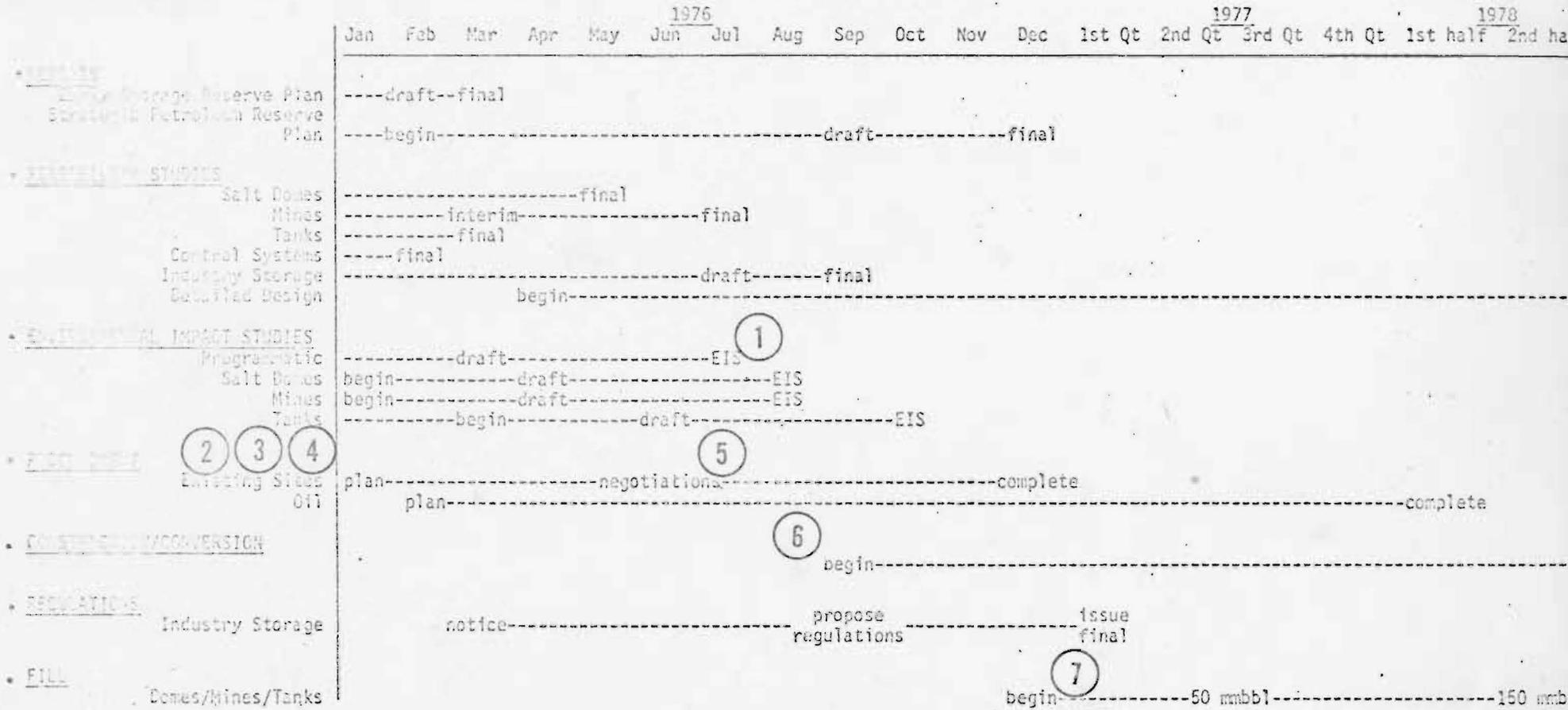
- Therefore OMB recommends the Administration take a pragmatic posture in making promises to the Nation on what can be achieved by:
 - . clearly stating to the Congress the early program targets will be extremely difficult to attain.
 - . indicating an accelerated schedule will be attempted but that it is more important to achieve implementation of a workable storage system at reasonable cost.
 - . stating that a firm commitment cannot be made to meet the 150 million barrels in 3 years because of the uncertainty and complexity of the program.
- A more detailed discussion of the specific concerns with FEA's schedule follows and is keyed to the numbers shown on Exhibit A.

Decision:

- Firm commitment to meet 150 million in 3 years (FEA)
- Make a solid attempt, but no firm commitment (OMB)



EARLY STORAGE RESERVE
Major Milestone Chart



2 3 4

5

6

7



Issue A - Implementation Schedule

- OMB's assessment of the EPCA requirement is that the 150 million barrels in 3 years is highly optimistic. While it is clear the Congress intended a best effort, it would be hard pressed to criticize the Administration if the target was not met because it is not possible. Environmental standards must be adhered to, costs must be held at a reasonable level and impacts on the private sector must be minimized.

OMB has the following basic problems with the FEA schedule which proposes a three-year implementation. (Refer to Exhibit A).

① Environmental Impact Statements (EIS)

- The preparation of a storage program environmental impact statement (EIS) is required as well as EISs for individual storage sites. At this time FEA is in the process of completing the draft programmatic EIS and plans to have it in final form by July 1976. Individual site EISs preparation has begun and is planned to be completed in August-November 1976 (5-8 months from now).
- FEA has not completed the draft programmatic EIS. CEQ advises that average time between release of a draft EIS and a final EIS in 1974 was as follows:

<u>Agency</u>	<u>Average Time Required</u>
Forest Service	9 months
Corps of Engineers	10 months
Bureau of Land Management	6 months
Federal Highway Administration	12 months
Environmental Protection Agency	7 months

For particularly complex projects (as this one is) the time required may be longer. Assuming the draft statement is completed by April 1, and an average of the above times experienced by other agencies of 9 months, FEA is likely to have a final EIA in January 1977 or six months later than the planned date of July 1976 (Exhibit A) as shown in the plan. The site EIS's would follow after the programmatic statement.

FEA's plan is based on sites selected through prefeasibility studies done for them. The studies to date indicate each site has various uncertainties associated with it, including ownership, availability, and environmental uncertainties. Significant additional technical work must be completed at each site before sites are judged technically sound.

At least three to four months are required for this work. Results must be positive for FEA to proceed at each site. If they are not, then the site would be dropped.

② Selection of Sites

After candidate sites are evaluated, a system of storage facilities must be selected which fit into a coherent storage system, consistent with the Nation's existing and expected petroleum distribution systems. Time required 1-3 months. This selection can be done on the basis of limited candidate sites, as planned by FEA, but the result will likely be more expensive and less desirable than a well considered program because better sites may be available but can't be used to meet time requirements.

③ Engineering and Design

Facilities must be designed for each site selected (both on site and off site, such as port expansion). This ordinarily follows EIS's, site feasibility studies, system design, site selection and acquisition. Naval Facilities Command advises that detailed design takes 12 months for a typical construction project. This task is not shown in FEA's plan (Exhibit A).



④ Obtaining Other Needed Regulatory Clearances

- The number and type of permits needed for a site have not yet been adequately identified by FEA. It is known that many will be required before construction can be undertaken. OMB analysis shows that Federal, state and local permits are likely to be needed for:

- . Water use permits, necessary leaching and filling of salt dome/mines.
- . Water disposal permits to permit leaching of cavities.
- . Site use permits.
- . Health and safety permits.
- . Pipeline rights of way and safety.
- . Numerous site easements for roadways, power, communications, security.

A given site cannot be used without necessary permits and considerable time will be necessary to acquire them.

FEA's plan (Exhibit A) does not identify this task in the plan nor does it provide a reasonable period of time for obtaining clearances. Experience by other Federal agencies for significant energy projects in obtaining permits prior to construction shows:

	<u>Average Time (in months)</u>
Agriculture-REA Electric Generating Plants	6-12
NRC Nuclear Powerplants	8-18
EPA Sewerage Treatment	5-12
FPC - Pipelines	2-48



6) Procurement of sites

FEA has initiated preliminary negotiations for site procurement in January 1976 prior to:

- . completion of the program EIS
- . completion of the site specific EIS
- . obtaining necessary regulatory permits.

Completing EISs, detailed feasibility studies, and negotiations on a concurrent basis will be difficult especially since some sites involve multiple owners. There is risk of acquiring sites and not being able to secure permits or encountering litigation on EISs.

5) Construction

FEA proposes to begin construction as early as September 1976. This appears impossible since EISs are planned for completion in August and the time for regulatory clearances is not shown. Further land has to be acquired and construction contracts bid and negotiated in a month according to this schedule. Also, until regulatory clearances are obtained, it would be unwise to commit the government to purchase a site or proceed with construction since denial of a single permit could mean the site can't be used.

7) Filling the facilities

A major constraint on successful achievement of the storage requirement is the rate at which petroleum can be loaded into storage. Crude must be loaded at a rate of 10 million barrels per month. There is little analysis to show that offloading facilities would be adequate to meet this rate.

Summary

In its effort to condense time required, FEA plans to do work on all sites simultaneously. This has been done for certain high priority projects but greatly complicates management problems. It is taxing for a seasoned agency and especially so for one without a project management team in place. Further, FEA has included in the schedule very little time for delays encountered on the EIS, permits, construction, etc.

In sum, the FEA schedule designed to meet the 3-year, 150 million barrel requirement is not realistic. A more likely schedule appears to be 4 years consistent with FEA's original consultant estimates and those of the National Petroleum Council. Considerably more analysis is needed on EISs, regulatory permits, site design, construction times before a realistic, complete schedule could be prepared.





B

ISSUE B Storage facilities and costs

Summary

	FEA Proposal	OMB Proposed Alternative	Reference Assessment
. Number of storage sites	Probably more than 9 sites.	5-7 sites	OMB believes fewer sites can provide needed capacity at lower cost per barrel with slightly less of a chance of meeting time frames in EPCA.
. Type of storage sites	4 existing salt domes 5 existing mines other new sites (not specified).	mainly salt domes, mines not excluded, but unlikely due to unknowns and higher costs.	OMB would rely on existing domes because they are lower in cost and involve fewer unknowns than mines. OMB would not exclude mines if it is subsequently determined they are cost competitive with domes and risks can be minimized.
. Estimated average cost per barrel of storage	\$1.33 per barrel	\$0.85 per barrel	OMB cost is based on salt domes including expansion of capacity. They are derived from FEA consultant estimates and increased by 20% for contingencies.
. Total estimated cost of storage facilities for 500 million barrels	\$667 million	\$425 million	OMB approach is \$242 million lower than FEA for 1976/1977 for facilities.



Background

- At present, there is a good deal of uncertainty about site availability, feasibility, suitability, and costs. Both FEA and OMB are using preliminary feasibility data to estimate costs. FEA's estimates include:

	<u>Millions of barrels</u>	<u>Cost per barrel</u>	<u>Funding for FY 76/77 (in millions)</u>
Existing cavities in salt domes (4 sites)	207	\$0.88	\$182
New cavities in salt domes (not specified)	124	1.39	172
Converted mines (5 sites)	<u>169</u>	1.85	<u>313</u>
Total	500		\$667

OMB basically agrees with FEA's proposed cost facility estimates for existing salt domes.

- The basis for disagreement is:
 - . FEA estimated costs for mines indicate they are much more expensive than domes.
 - . Use of a larger number of sites (9 or more) than are needed.
 - . FEA estimated costs for new salt dome cavities are much higher than their consultant cost estimates.



1. Use of mines at \$1.85 per barrel

- FEA bases its budget request on the use of some 12 existing mines, five of which are listed in its prototype program. Its reasons for including these sites are three:
 - . Mines may prove feasible and if they do, they may be available more quickly than domes.
 - . Mines enhance the government's bargaining position for domes by, in effect, providing a price ceiling on domes.
 - . By including mines in the appropriation request, FEA insures that it will be immune from challenge under NEPA that alternatives other than domes were excluded.
- OMB does not exclude the use of mines (\$1.85 per barrel) if they prove to be competitive with domes, i.e., can be developed at not more than \$.88 per barrel:
 - . Available data indicate that proposed mines may involve safety and environmental problems.
 - . Mines lose much of their relative time advantage over domes if, as is reasonable, the program experiences any delay. The proposed mines are working mines and would have to be shut down or relocated. FEA does not expect any delay in doing this but was unable to furnish data on current employment at the mines, relocation expenses, or anticipated resistance by current miners.
 - . Mines have limited economies of scale compared to domes. Cost of mines are at this point uncertain but considerably in excess of domes (\$1.85 versus \$0.88).
 - . The government's bargaining position is enhanced by increased flexibility on timing and a credible interest in the alternative to domes with existing cavities, namely the dozen or so more suitable sites which FEA maintains could be prepared within 5 years at a cost below that estimated for mines.
- OMB's recommendation does not preclude the use of mines if they are competitive with domes at \$0.88 per barrel and are consistent with NEPA.

Decision

\$1.85 per barrel (FEA)

\$0.88 per barrel (OMB)

2. Use of larger number of sites than are needed thereby increasing costs

- FEA budget request is based on a tentative storage system containing about nine storage sites to meet the need for 150 million barrels in 3 years and to provide additional facilities for subsequent expansion of the storage system.
- OMB agrees that sites with existing caverns provide an advantage in any attempt to meet the expedited time frames of EPCA. OMB disagrees with FEA that nine or more sites are needed because:
 - . Salt dome sites have been identified with an existing capacity of 207 million barrels. In addition, over 12 new salt domes have been identified with desirable characteristics. The potential capacity of four of the sites with existing capacity is as follows:

	(millions of barrels)		
	<u>Existing</u>	<u>Potential *</u>	<u>Total</u>
. Bryan Mound	36	200	250
. Bayou Choctaw	88	70	160
. West Hackberry	58	440	500
. Sulfur Mines	<u>25</u>	<u>N/A</u>	<u>N/A</u>
Grand Total	207	710	910

* Additional cavities may be leached at each site to expand capacity .

- . Using FEA's schedule and FEA's cost estimates, EPCA's 150 million barrel requirement would be achieved in 3 years and four months at a total cost of \$182 million, with some reduced chance of meeting the 3 years because fewer existing sites could be selected at the lower cost of \$.88 per barrel than the average of \$1.33 proposed by FEA.
- It is important to be able to deliver oil at a sufficient rate during an embargo within the Nation's existing and future distribution system. Doing so, however, does not appear to require the use of more than 5-7 storage sites. The National Petroleum Council recommended 2 or more dome sites in conjunction with superports or 3 or more sites without the superport facilities. Five to seven sites appear adequate for the 500 million barrel system.



- On the basis of current information, the use of the smaller number of salt dome sites (5-7) results in significantly lower cost per barrel of storage because:

- . there are fixed costs associated with each site that must be incurred regardless of size. These costs include land acquisition, pipelines in and out, pumps, docking facilities.
- . significant economies of scale may be achieved when a given site is expanded because fixed costs are spread over a greater number of barrels of storage and they do not increase in direct proportion to increased volume. For example, FEA consultants estimate that costs drop from \$1.70 per barrel to \$0.80 per barrel when a new dome facility is expanded from 20 to 70 million barrels.

Building three separate 20 million facilities costs \$102 million.

Building one 70 million barrel facility costs \$56 million.

Once a site is acquired, expansion may be accomplished by leaching new cavities on that site. The cost of leaching new capacity is significantly lower on a per barrel basis than acquiring a new site according to FEA consultants and FEA's draft report to Congress.

- A recent National Petroleum Council study on strategic storage recommends the use of 2-3 new salt dome sites for 500 million barrels of storage. The report indicated significant savings in construction costs could be achieved as the amount of storage is expanded at a given site.
- A smaller number of salt domes sites with greater capacity at each site should result in lower facility costs (\$242 less than proposed by FEA) and can still result in 150 million barrels of storage in 3 years and four months according to FEA's schedule but with a lesser degree of assurance.

- Decision

- . More than 9 sites (FEA)
- . 5-7 sites (OMB)



3. FEA's estimated costs for new or expanded salt domes.

- FEA's budget request estimates the cost of storage either at new salt dome sites or by expanding existing sites with new cavities at \$1.39 per barrel or \$.51 per barrel more than acquiring existing sites.
- FEA's consultant estimates the range of cost for new salt dome sites at \$0.50 per barrel to \$0.80 per barrel.
- According to FEA, the difference is that the consultant failed to include certain costs for docks, storage tanks, that will be needed for new sites.
- OMB disagrees with FEA's estimate because:
 - . FEA's estimate includes 4 existing dome sites of 207 million barrels capacity which may be expanded at a lower cost than acquiring new sites since many of the items which FEA is concerned about will have been installed, and they can be built at the appropriate scale.
 - . While the consultants' estimates may fail to include certain costs, the FEA estimate of \$1.39 is about twice the consultants' estimate of \$0.50 - \$0.80 per barrel.
 - . Complete cost estimates for new sites and expansion of existing sites will not be available until June.
 - . Existing dome sites are estimated at \$0.88 per barrel indicating an approximate cost for salt dome facilities.
- OMB recommends using \$0.88 per barrel for budget purposes at this time.

Decision

Use \$1.39 per barrel for new or expanded salt domes (FEA)

Use \$0.88 per barrel for new or expanded salt domes (OMB)



c

ISSUE C - Industrial Storage

- In the Early Storage Reserve plan (required to be submitted to Congress by March 21), FEA proposes to include a tentative proposal that the Administration may ultimately require importers and refiners to store up to 180 million barrels of petroleum with 55 million of the total to be included in the early program.
- OMB does not oppose the use of industrial storage at this time but believes that before proposing it, a study is needed to determine:
 - . the impact on refiners/importers, e.g., will they be able to raise the \$2.7 billion needed?
 - . how best to implement the approach, e.g., is it feasible to provide government owned facilities?
 - . the political consequences, e.g., will the small refiners/importers be exempted?

FEA now has a study under way but it will not be completed until September 1976.

- FEA argues that they need to propose industrial storage now in order to show how they will meet the early storage requirement of 150 million barrels in 3 years. If this is not done, then the government would have to budget for an additional 55 million barrels of oil at a cost of \$440 million in 1978. They further maintain that if industrial storage is not included in the plan now, it becomes subject to Congressional approval subsequently if the plan is amended to include it. As noted above, however, amendments to the Early Storage Plan are not subject to Congressional disapproval.
- OMB recommends:
 - . the decision be postponed,
 - . the study be expedited and completed by June 1976 and at that time a decision on whether and when to require industrial storage can be made.



- There is no need to budget now for 55 million barrels of storage in 1978 because the decision on industrial storage can be made this summer once the study is complete. If the decision is in favor of industrial storage, then the Early Storage Plan can be amended by transmittal to Congress. Such an amendment to the Early Storage Plan is not subject to Congressional disapproval.

Decision

Include Industrial Storage in plan (FEA)

Postpone decision, expedite the study (OMB)





D

ISSUE D - Price of Oil for Storage

- The Energy Policy and Conservation Act authorizes the following sources of crude for the storage system.
 - . crude oil produced from Federal lands, including crude oil produced from the Naval Petroleum Reserves.
 - . crude oil which the United States is entitled to receive in kind as royalties from production on Federal lands; and
 - . petroleum products acquired by purchase, exchange or otherwise.
- Both FEA and OMB agree that it is best to sell NPR oil until price controls expire and use the proceeds to purchase needed oil for storage because:
 - . NPR oil can be sold at uncontrolled oil prices which are likely to be \$13-\$14 per barrel. This revenue will be needed to offset NPR development and production costs and the cost of the accelerated storage program as required by EPCA, which could total \$8 billion.
 - . Due to the continuation of price controls until early 1979, other sources of oil for storage are available at a cost that will be lower than the \$13-\$14 per barrel which NPR oil will realize. For example, the current price of old domestic crude oil is \$5.25 per barrel. Use of lower cost oil will lower the cost of oil to the government. However, the cost to the Nation would be the same.
 - . It is less expensive to sell NPR oil on the West Coast and buy crude for delivery in the Gulf Coast than to transport NPR oil to the Gulf Coast.
- FEA proposes to use a combination of Federal royalty oil and oil purchased at the national average price. Royalty oil is produced from Federally leased lands and owed to the government by the lessee. The government has rights to 1/8th the oil produced from on shore lands and 1/6th the oil produced off shore. This oil is currently sold to small refineries at an average price of \$6.44 per barrel for annual receipts of \$260 million (both old and new oil). Approximately 110,000 barrels per day or 40 million barrels per year are available from this source. To the extent royalty oil is not available to meet the needs of the storage program, FEA proposes to purchase remaining needs at the national average price (now \$9.80 per barrel). This would be accomplished by purchase of old and new domestic oil and imported oil in a mix designed to achieve the average.



- The different costs of the alternatives that are authorized by EPCA are summarized for the Early Storage Reserve (150 million barrels). The amounts are for 95 million barrels and assume the remaining 55 million barrels will be industrial storage at no cost to the government.

	Dollars (in millions)				Total
	<u>FY 1976</u>	<u>FY 1977</u>	<u>FY 1978</u>	<u>Cum BBIs.</u>	
1. Old domestic crude	\$ 5	\$263	\$231	95	\$499
2. Royalty/national average	10	439	326	95	775
3. Imported oil	15	739	704	95	1,458

Each alternative will require subsequent (after 1979) government expenditures of about \$5 billion to complete the 500 million barrel program called for by EPCA assuming decontrol of domestic oil prices. Costs are the same in each case since price controls are assumed to expire in early 1979.

- OMB disagrees with FEA on committing to the use of \$8.80 per barrel oil including royalty oil because:
 - . an evaluation has not been made on what the impact would be on small refiners who now realize a considerable subsidy as a result of being able to purchase royalty oil.
 - . there is likely to be considerable negative reaction by small refiners resulting in political pressure against this action.
 - . the Secretary of Interior strongly objects to the use of royalty for storage since it would adversely impact small refiners.
 - . other possible sources such as old domestic crude (\$5.25 per barrel) are cheaper, available, and can be used without adversely impacting a single group such as small refiners.
 - . EPCA explicitly states that petroleum acquisition should be consistent with encouraging competition in the petroleum industry.
- OMB recommends that old domestic crude at \$5.25 per barrel be used for storage because:
 - . Federal budget will be reduced by \$150 million in FY 77 and a total of \$220 for 95 million barrels needed for the early program.
 - . The beneficiaries of the program, the general consuming public, would help pay for the program. The cost (1/20¢ per gallon) would be small.
 - . The use of low cost domestic crude would have only a small and insignificant increase in overall petroleum prices (1/20 of a cent per gallon).



- . Nearly 4.5 million barrels of old domestic crude are produced in the U.S. each day. The amount needed for storage purposes is only 200,000 barrels per day.
- . There are a number of ways that FEA can secure the old oil including:
 1. Acquire old OCS oil by using the provision of the OCS Act that gives the government the right of first refusal to purchase at the market price. OCS oil "in time of war, or when the President shall prescribe."
 2. Solicit bids for oil, and take the lowest ones. These should turn out to be for old oil.
 3. Allocate old oil to the government.
 4. Use the entitlements program to obtain old oil.
- OMB believes that one or a combination of these policies will permit the government to acquire old oil for the storage program. A decision on the exact mechanism can be deferred for several months until the most desirable approach is worked out. Thereafter, changes can be made.

Decision

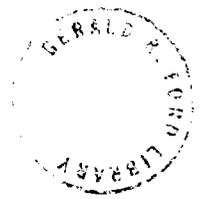
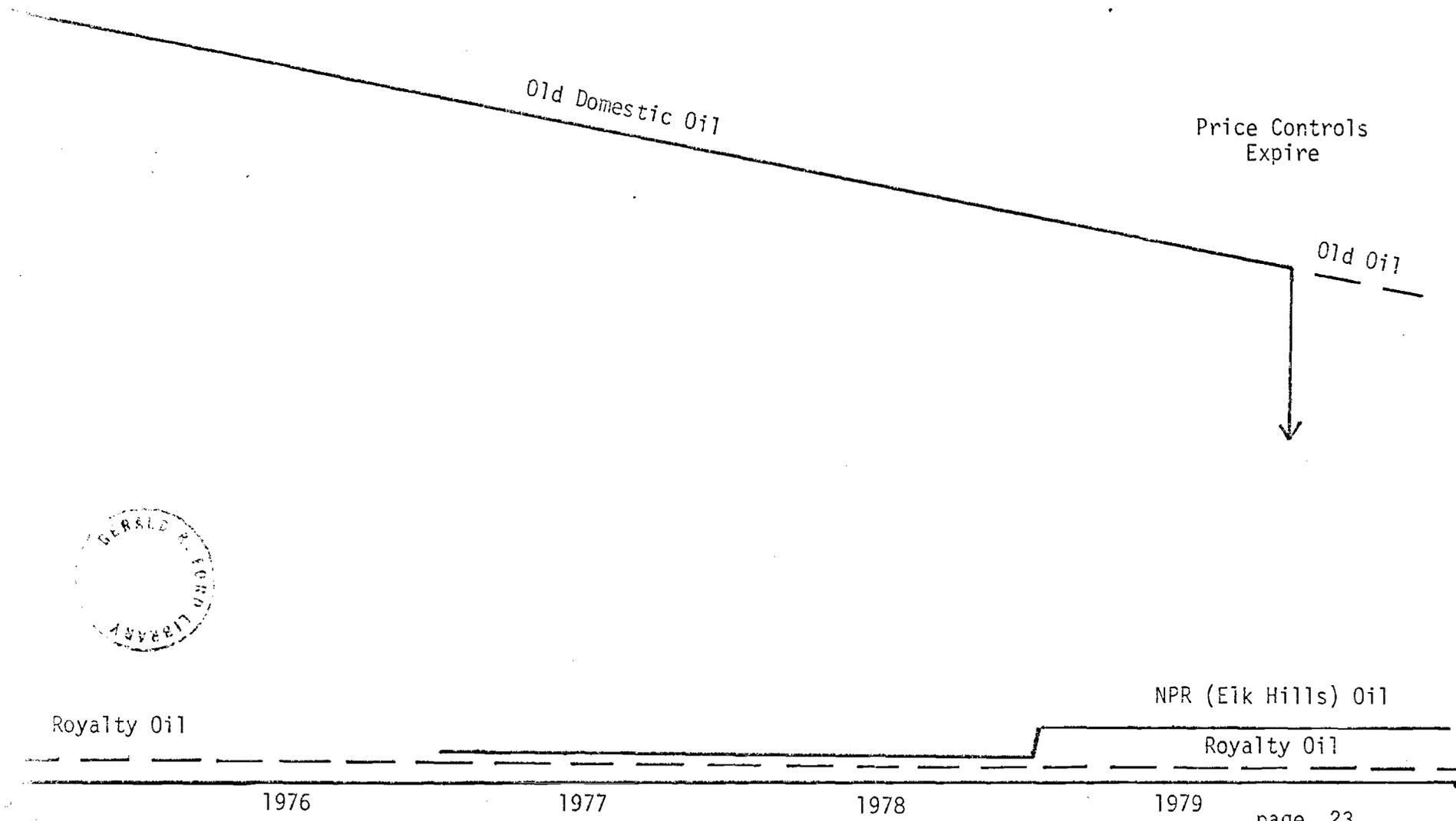
Use royalty/national average price for oil (\$8.80) (FEA)

Use old oil (\$5.25) (OMB)



Comparison of Oil Production for
Old Domestic, Royalty and NPR (Elk Hills)

Thousands of
Barrels of
Production/Day



E

ISSUE E - Regional Storage

- OMB and FEA agree that we do not need "regional storage," that is storage of petroleum in locations such as the Northeast, to comply with EPCA's requirements.
 - Regional storage could add substantially to the cost of the program (up to \$600 million).
 - It would involve additional delays and environmental problems and could result in a pork barrel program.
- You should be aware, however, that the following people may disagree with this decision.
 - Interests in the Northeast, who may assert there will be a shortage of residual oil and home heating oil in the event of an embargo.
 - Interests in Hawaii who may claim that their crude supplies could be shut off.
- Both FEA and OMB agree that these objectives can be answered as follows:
 - EPCA requires that their needs be protected, not that petroleum be stored in their area, and the Administration plan protects them.
 - Crude would be provided to New England and Caribbean refineries, which supply the needs of the Northeast.
 - Centralized storage saves taxpayers and consumers up to \$600 million and prevents unnecessary environmental damage.

