The original documents are located in Box C43, folder "Presidential Handwriting, 6/30/1976 (1)" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.

THE WHITE HOUSE
WASHINGTON

Jim -

When I asked Zarb's office where the memo of June 8th was I was told that it was walked into the President and was so secret that the President gave it back to Zarb and Zarb had it.

Do you think we should firmly request a copy or just put a note on file?

Trudy 6/30/76

copy coming per Peg

7/2/76 - Jim Connor received & said file ABF 5/13

CONFIDENTIAL (State Derivative)

00778

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

June 28, 1976

OFFICE OF THE ADMINISTRATOR

THE PRESIDENT HAS SEEN....

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB

SUBJECT: CRUDE OIL PURCHASE FOR THE STRATEGIC PETROLEUM RESERVE--DISCUSSIONS WITH IRAN

In my memorandum of June 8, 1976, I outlined a proposal under which the United States would purchase from Iran 300 million barrels of crude oil for the Strategic Petroleum Reserve (SPR). I indicated at that time that I planned to explore with Iran their interest in supplying this crude oil on the basis of a fixed price contract over six years in exchange for a prepayment of at least $1 billion.

On June 11 in Paris I presented the proposal concept to the Iranian Minister, Hushang Ansary. As could be expected, Ansary was not attracted by the price freeze concept, indicating that Iran would find it difficult to break with OPEC policy for such a relatively small volume. He was, however, attracted by the advance payment idea, and with the possibility that the U.S. might increase the SPR to 1 billion barrels. The meeting ended with Ansary undertaking to develop a counter proposal which he expects to present to me in late July. It will probably include some form of price escalation.

At this stage, I am not optimistic that the Iranian counter proposal will contain sufficient common ground with our proposal to warrant further negotiations. Worldwide oil demand is increasing and it seems that Iran will have no difficulty in selling incremental

CONFIDENTIAL (State Derivative)

oil production, notwithstanding the possibilities presented by the arms/oil barter deals and the Occidental share purchase arrangement. Until we have a better idea with respect to the Iranian counter proposal, I do not intend to discuss the concept with key Congressional leaders, as was suggested in my earlier memorandum.

I will continue to keep you informed.

Trudie Fry:

Attached is the June 8 Secret memo to the President.....Mr. Zarb hand carried it into the President during their meeting on the subject...and the President returned it to Mr. Zarb.

Attached is for your files.

P Burris

SECRET

(State Derivative)

00779

THE PRESIDENT HAS SEEN....

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

June 8, 1976

OFFICE OF THE ADMINISTRATOR

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB

SUBJECT: CRUDE OIL PURCHASE FOR STRATEGIC PETROLEUM RESERVE

Summary of Proposal

We plan to explore with Iran, without commitment, their interest in supplying 300 million barrels of crude oil to the United States for the Strategic Petroleum Reserve (SPR). In exchange for U.S. prepayments of at least $1 billion, a fixed price contract affording protection against OPEC price increases would be sought. Savings in acquiring crude oil for the SPR in excess of $0.5 billion could be realized. If Iran is interested, your approval will be sought on final terms.

Background

The Government of Iran has, since the Summer of 1975, expressed interest in selling additional oil to the United States. Iran's ambitious development plans and military procurement programs have been jeopardized by declining revenues from oil sales, reflecting sluggish recovery in the world economy and competitive price disadvantages of Iran's heavy crudes vis-a-vis those of other producers.

In efforts to sell more crude oil, Iranian officials have attempted to interest the United States Government in applying pressure on Consortium companies to lift more oil, and in direct or indirect government-to-government sales of oil. Barter deals, oil for arms, are a more recent development. A crude purchase deal amounting to 500 thousand barrels per day was considered early in 1976, but further consideration was deferred in the absence of clear Administration policy and authority with respect to the purchase and resale of oil.

Copy 1 of 4

(State Derivative)

SECRET

Proposal

Developing a viable proposal must take into account some potentially conflicting considerations:

- To be attractive to the U.S., a significant benefit must be realized, in the form of savings in the purchase cost of crude.

- The savings must be easily identifiable to the U.S. Congress and public, and must, therefore, be presented in terms of a discount off OPEC price.

- To be acceptable to the Iranians, vis-a-vis its fellow OPEC members, no initial price discount must be apparent.

- Iran needs immediate revenue from oil sales in excess of volumes that might be sold on an annual basis to the U.S.

The Energy Policy and Conservation Act (EPCA) authorizes the creation of a Strategic Petroleum Reserve (SPR). Present studies indicate an SPR of at least 500 million barrels would be required by 1983. The quality of crude oils required is such that approximately 60 percent of the SPR, or 300 million barrels, could be supplied by Iran.

The planned fill rate for the SPR--small volumes beginning in the second half of 1977--would not meet Iran's indicated need for immediate, large amounts of incremental revenue. It may be possible, therefore, to exact a significant price benefit in exchange for immediate revenue.

The parameters of the proposal under consideration are as follows:

- Iranian Government commitment to supply and USG commitment to purchase approximately 300 million barrels of crude oil over six years.

- An initial payment of at least 20 percent of the total cost upon signature of the contract; a second payment of at least 10 percent of the total upon initial delivery of crude in 1977; and final payment of the balance upon completion of all deliveries in 1982.

. Prices for crude oils, determined by quality, fixed for six years. Average prices would be about $11.25 per barrel FOB Persian Gulf. Protection against OPEC price deterioration during contract term would be sought. (Anticipating later negotiations, our initial price offer would average $11.00 per barrel.)

Economics

The economics of the proposal have been evaluated against several assumptions with respect to rates of growth in world oil prices. The base case assumes prices remain constant at current levels. It is considered unlikely, however, that prices will either remain constant or decrease. Two price increase cases, therefore, have been assumed, a 5 percent annual increase case and a 10 percent case.

A number of prepayment schemes have also been examined. Cases with a minimum "front-end" payment of one-third, or $1 billion, and a maximum of one-half, or $1.6 billion, of the total purchase cost of $3.2 to $3.4 billion have been evaluated. Similarily, prices ranging from $11.00 per barrel to $11.50 per barrel have been assumed.

A summary of the economics of the proposal follows:

Volumes to be Purchased 300 million barrels

	Minimum Case	Maximum Case
Price Assumed	$11.00/barrel	$11.50/barrel
Initial Payment (1976)	$1.0 billion	$0.7 billion
Second Payment (1977)	--	0.7
Final Payment (1982)	2.2	2.0
Total Cost	$3.2 billion	$3.4 billion

Maximum Advance of U.S. Funds — $1.6 billion in 1977

Year When Value of Oil Received Equals Advance — Late 1979

	Assumed Annual Price Increase		
	No Increase	5 Percent	10 Percent
Net Savings to USG Over 6 Years of Prepayment Proposal vis-a-vis Annual Purchase			
$ Billions	0	0.5	1.1
$ per Barrel	0	1.65	3.55

The proposal may be viewed as "zero cost insurance" against OPEC price increases. The "No Increase" case column indicates that the U.S. runs no financial risk of even the unlikely event of constant OPEC prices. Significant savings ($0.5 billion) are enjoyed if prices rise by only 5 percent per year.

Constraints

There are a number of constraints, legal and otherwise, which must be considered:

- Procurement legislation prohibits sole-source purchase contracts except under specific circumstances, which do not apply in this instance. Special legislation would probably be required, as part of the overall SPR Plan, to authorize the proposed arrangement.

- Jones Act provisions, requiring the use of U.S. flag vessels, would apply to at least 50 percent of the oil acquired by the USG. All oil for the SPR would be affected. In order to reduce the landed cost of foreign oil, and to comply with budget objectives, it may be advisable to seek exemption of the Jones Act for SPR oil.

- "Front-end" payments to Iran of $1.0 billion or more and three years' financial exposure may be difficult to justify.

To meet these concerns, after an expression of interest on Iran's part, but before negotiating the proposal, key Congressional leaders would be consulted. The final "deal" would, of course, be subject to Congressional and public scrutiny, and must, therefore, provide an easily identifiable economic benefit to the United States.

The problem of public presentation is not insignificant. From a U.S. standpoint, the proposal must be presented as insurance against OPEC price increases in exchange for advance payments. For Iran, the proposal must be presented in terms of current revenue at the cost of enjoying higher prices in the future. Iran places great value on oil price increases to offset world inflation. Iran can be expected to negotiate strenuously for a minimal price discount with an escalation factor. The proposal is not, therefore, assured of acceptance. Our initial price offer would be in the $11.00 range.

Next Steps

This proposal has the support of State, CEA and NSC.

We intend to explore on a confidential basis, with the Iranian Minister of Finance, the feasibility of the concept, without commitment and with full disclosure of the constraints noted above. We will report to you the Iranian Government reaction, and seek your approval to proceed further with Congressional consultations prior to entering into negotiations with Iran.