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STATEMENT

of

FRANK G. ZARB

ADMINISTRATOR

FEDERAL ENERGY ADMINISTRATION

Before the

COMMITTEE ON INTERIOR AND INSULAR AFFAIRS

UNITED STATES SENATE

April 5, 1976



Mr. Chairman, I am pleased to appear before the Committee this morning to testify on FEA's actions concerning the implementation of the provisions of the Energy Policy and Conservation Act. I would like first to describe FEA's actions with respect to the three stages of rulemaking having to do with crude oil pricing and then describe for the Committee other actions taken with respect to FEA regulations to comply with the provisions of the EPCA.

It is a particular pleasure to discuss our efforts to implement the provisions of the EPCA, because this has been the number one priority at FEA since the passage of the Act. We have virtually every person at FEA who is able to contribute to this process fully engaged in the efforts to translate the provisions of the Act into implementing regulations in a timely fashion. Since the bill was signed on December 22, we have issued 14 proposed rulemakings, held 16 public hearings at which 545 witnesses testified, received and analyzed 1,060 written comments on proposed rules, and promulgated 8 final rules under the authority of the EPCA. We still have a substantial amount of work to do and are committed to getting it done as quickly as possible, subject, of course, to complying with all of the provisions of the Act. For


your assistance, my staff has prepared a chronology of FEA's activities in implementing the EPCA, which I am making available as Appendix A to my prepared statement today.

In addition, other elements of the agency are working equally hard to implement the provisions of the EPCA, which do not amend the Allocation Act, to include appliance labeling standards, industrial energy efficiency standards, strategic storage program, contingency planning responsibilities and the like.

I would like now to discuss briefly the two most significant areas of FEA's endeavors to implement the EPCA--crude oil and related pricing provisions and elimination of unnecessary regulations, including the exemption of certain products from regulation as appropriate. I am also submitting with my written testimony an outline (as Appendix B) of FEA's actions to implement the EPCA which will provide more detail than my statement.

Crude Oil and Product Pricing Regulations

With respect to implementation of the pricing provisions of EPCA, our efforts have been divided into two principal categories. The first has to do with the implementation of the crude oil and product pricing provisions mandated by the EPCA. The second has to do



with our efforts to comply with the provisions of the Act regarding exemption of certain product categories and conversion of existing regulations to standby status.

We have approached our crude oil price rulemaking in three major phases. The first phase was to establish a composite price for the first sale of all domestic crude oil of \$7.66 per barrel in February, as required by the EPCA. A Notice of Proposed Rulemaking was issued on January 6, 1976, public hearings were held on January 22 and 23, and final regulations were issued on February 1, 1976. These regulations established two price tiers for all domestic crude oil. The lower tier comprises what had been old oil under previous regulations and the upper tier comprises what had been new, released and stripper well oil under previous regulations. The ceiling price for lower tier crude oil was retained: that is the highest posted price in the field on May 15, 1973, plus \$1.35 per barrel. The upper tier ceiling price was set at the highest posted price for new, released and stripper crude oil in the field on September 30, 1975, less \$1.32 per barrel. Based on our best estimates, this regulation will result in a weighted average first sale price of \$5.25 nationally for lower tier crude oil (which will comprise approximately 60 percent of total domestic production), and a weighted average first sale price of

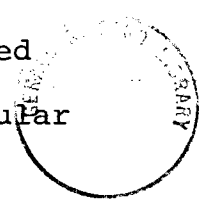
\$11.28 nationally for upper tier crude oil (which will make up the remaining 40 percent of domestic production). The resulting national weighted average first sale price for all domestic crude oil production in February 1976 will then be \$7.66.

We have also submitted to the General Accounting Office for clearance and are now implementing a new data collection system that will permit us for the first time to capture data on the first sale price of all domestic production. When these data are in hand, we will be able to measure the extent to which, if at all, the actual February 1976 prices for domestic crude oil production deviated from our current estimates. Any such deviations will, of course, be corrected by subsequent offsetting adjustments in the maximum lawful prices for the two tiers so as to achieve the composite price required by the EPCA.

The second phase of our crude oil price rulemaking deals with the distribution of the escalator provisions available under EPCA. The reason we elected to treat this issue immediately after establishing the composite price was to reduce to the minimum the uncertainty about the course of future prices for domestic crude oil production. Members of the industry, particularly those

independent operators who account for the majority of new reserves found, impressed on us the necessity of resolving quickly the uncertainty about the future price paths of both lower tier and upper tier crude oil so as to facilitate their investment, exploration, and production decisions. A Notice of Proposed Rulemaking on the escalator provisions was issued on February 26, 1976. Hearings were held on March 17 and 18, and we will issue final regulations in the next few days. Our intention is to publish every six months a price schedule for both upper tier and lower tier oil for each of the months remaining of the 40-month control period, based on the application of the available escalator provision. It is also our intention to make any necessary adjustments to compensate for divergence of the actual weighted average first sale price of domestic production from the target price in the development of these semiannual price lists. Thus, once every six months we will issue a schedule showing what the prices will be for each month of the program. This procedure will minimize the industry's uncertainty as to future prices for crude domestic production.

In our third phase of crude oil pricing we intend to deal with those special opportunities for increased domestic production, that because of their particular



circumstances may not be economic even at the upper tier prices generated by the application of the escalator provisions. These include the development of offshore leases, the completion of deep horizon development, the treatment of wells that produce large amounts of water compared to the amounts of crude oil produced, especially high cost enhanced recovery techniques such as polymer injection and the like, and stripper well production. This third stage rulemaking will also deal with the question of what additional incentives, if any, may be required to allow upper and lower tier prices, and therefore the national composite price, to at least remain constant in real dollar terms. Finally, it will deal with additional incentives that may be required for other special categories of production such as heavy California crude oils.

A fourth series of rulemakings, some of which have been completed and some of which are still underway, is being conducted to conform FEA's price regulations to other specific provisions of the EPCA not related directly to crude oil pricing. These include the treatment of banked costs, proportionate allocation of costs passed through on cost decreases, implementation of the small refiner exemption from entitlements purchases, changes in

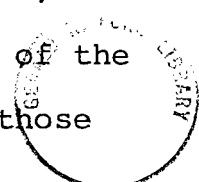


the old oil allocation (entitlements) program, and certain other specific measures. Details of these have been provided in the outline of regulatory actions furnished the Committee and included as an attachment to my testimony. One of the most important actions in this category was the adoption on March 29 of amendments to FEA's old crude oil entitlements program to restore effective competition to the East Coast residual fuel oil market.

Elimination of Unnecessary Regulations and Exemption from Controls

The second major effort underway to implement the EPCA provisions has had to do with meeting the statutory requirements for removing unnecessary regulations. Section 454 of the Act requires an intensive reevaluation of all of FEA's existing regulations.

Public hearings on this question were held in 13 locations throughout the United States on February 17, 18, and 19, at which 226 witnesses appeared. A detailed report of the results of these hearings and other information available to FEA is now in preparation and is due to be submitted to Congress on April 19, 1976. However, it is clear from the summary of the testimony in each of the 13 hearings that the overwhelming majority of all those



testifying expressed the opinion that our current regulations, designed to operate during a shortage of crude oil and petroleum products, are either useless or often counterproductive in a period of adequate and even surplus product supplies.

In parallel with this effort of reevaluating the detailed regulations we have begun a series of studies to determine whether we can make the findings required in the Act to propose exemption of certain product categories from the regulations and conversion of those regulations to standby status. A study of the first product category, residual fuel oil, has been completed; public hearings were held on March 9, and a proposal for exemption was submitted to the Congress on March 29. Studies on three other product categories--motor gasoline; #2 heating oil and diesel fuel; and lubricants, oils and greases--are nearing completion. If the results permit us to conclude tentatively that we can make the necessary findings to exempt these products from regulation, we will hold public hearings on them in the near future. Depending on our evaluation of the comments received, we may well submit additional proposals for exemption sometime in May.

Mr. Chairman, this summarizes the major actions taken, under way, and contemplated to implement the provisions of

the EPCA. As I have previously noted, additional detail on each of these actions and a specific sequence of actions taken are included as attachments to my testimony. This concludes my formal statement and I would be pleased to answer any questions the Committee may have.

