THE WHITE HOUSE

WASHINGTON

January 17, 1976

MR. PRESIDENT:

Re: U.S. Government Oil Purchase Agreement

The attached memo from Frank Zarb has been staffed to Phil Buchen, Jack Marsh, Brent Scowcroft, Bill Seidman and Jim Lynn and has elicited the following comments:

Jack Marsh --	Support FEA
Bill Seidman --	Agree with FEA -- discount too small and indexation feature is very bad.
Phil Buchen --	See detailed comments at Tab A
Brent Scowcroft --	(see detailed comments at Tab B)
Jim Lynn --	Concurs with FEA

Jim Connor

00587

THE PRESIDENT HAS SEEN....

~~SECRET~~ (State Derivative)

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

January 13, 1976

OFFICE OF THE ADMINISTRATOR

MEMORANDUM FOR THE PRESIDENT

FROM: Frank G. Zarb

SUBJECT: U.S. Government Oil Purchase Agreement

Proposal

The USG has the opportunity to negotiate with Iran an agreement for the purchase of 500 MB/D of crude oil for a period of five years, at prices below OPEC levels and with price adjustments tied to changes in the U.S. wholesale price index. The State Department proposes to negotiate for a firm discount of at least 50 cents per barrel with further savings anticipated on periodic price adjustments. Defense and FEA believe a firm discount of at least $1.00 per barrel is necessary to minimize the risk of short-term loss by the USG in reselling the oil. Iran's interest in the agreement reflects anticipated financing difficulties in meeting its development and military needs and the low level of demand for Iranian crude in the currently depressed market.

Mechanics

The USG would purchase the oil directly from Iran and resell it to U.S. companies for delivery to the U.S. The Technical Purchasing Authority (TPA) provision of the Energy Policy and Conservation Act (EPCA) would provide enabling legislation, although the required appropriations legislation would be enacted only after the Congress had the chance to review the proposal. (A more detailed paper developing the mechanics of the proposal is attached.)

Advantages and Disadvantages of Proposal

The principal advantages of the proposal identified by the interested agencies are essentially international and political.

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. The relationship between the U.S. and Iran would be strengthened, and a possible severe cutback in Iranian purchases of U.S. military equipment and industrial goods could be averted.

. A measure of instability would be introduced into the international oil market by Iran's violation of OPEC agreements, and the doubling of Iran's share of the U.S. market at the expense of other OPEC countries. These factors could weaken the OPEC cartel's ability to unilaterally establish prices and production levels.

. The U.S. would switch about 8 percent of its oil imports to a cheaper and a politically more secure (i.e., non-Arab) source. An estimated annual savings of $180 million--assuming an average $1.00 per barrel discount--versus a total import oil bill of over $28 billion would result.

The principal disadvantages of the proposal identified by Defense, CEA and FEA focus on the energy and economic aspects and the domestic political implications.

. Involving the USG in the business of buying and selling oil would encourage those proponents of greater governmental involvement in the oil industry generally and of nationalization of imports more specifically.

. The amount of savings to be gained is not significant and the benefits to consumers would not be identifiable.

. The 500 MB/D lifted from Iran would displace some liftings from Saudi Arabia, which probably would threaten the US/Saudi relationship.

. The size of the discount would not significantly undermine OPEC's strength, and the indexation feature would represent an unfortunate precedent, not only with respect to Iran, but also with respect to other oil producers and raw materials exporters in general.

. The market and revenue pressures on Iran that have caused Iran to seek a bilateral agreement with the U.S. represent precisely the OPEC vulnerability to market forces that consuming countries are trying to encourage.

. The nature of the advantages preclude their being discussed publicly with Congress, either because of the political sensitivity of the issue or because the economic advantage would not be deemed to be significant.

Consideration of a Possible Alternative

If it is decided not to pursue the proposal currently under consideration, the possibility of entering into a sizable oil purchase agreement to fill the strategic reserves mandated by the EPCA may warrant consideration. Since the USG, under such an arrangement could commit the oil to reserves and therefore obviate any market impact, a potential supplier might consider a deep enough discount, providing sufficient economic benefit, to override domestic political considerations. Such a proposal could be evaluated in the context of the Early Storage Program and the Strategic Storage Program presently being developed in the Federal Energy Administration.

Conclusion

State discounts the disadvantages outlined above and argues that the advantages far outweigh them. However, in view of the positions taken by Defense, CEA and FEA, State accepts their conclusion that a decision on the proposal should be deferred for further evaluation of the likely responses of the oil market and of the Congress.

00588

~~SECRET~~ (State Derivative)

DISCUSSION PAPER

MECHANICS OF OIL PURCHASE AGREEMENT

Basic Assumptions

The USG will purchase from Iran for a period of five years 500 MB/D of crude oil. The USG will resell the oil F.O.B. Persian Gulf, in the form of "rights to lift" to U.S. companies operating refineries in the U.S. or at offshore locations with the resultant product destined for the U.S.

Mechanics

A basic contract between the Governments of Iran and the United States would commit Iran to sell and the USG to buy 500 MB/D of crude oil (light and heavy) for a period of five years. On a monthly basis, or for longer periods if desired by the USG, rights to lift would be issued by Iran which would in turn be sold by the USG to American companies. The USG would not physically possess the oil at any time. Transfers to U.S. companies would be effected F.O.B. Persian Gulf. The USG would pay Iran on a monthly basis for the basic amount contracted. Special arrangements would be made for the "start-up" period.

The USG has two basic options in transferring the rights to lift to U.S. companies.

1. An auction could be held by the USG of the rights to lift at the prices contracted between Iran and the USG. Potential buyers would submit bids reflecting their determination of the value of the particular rights. An auction provides a market test and is the preferred option.

2. Tickets may be issued or sold to all U.S. refiners/importers in proportion to refinery runs or imports in the total amount of 500 MB/D. Tickets would entitle the holder to purchase the available crude at prices determined by the USG, either the full amount of the discount received from Iran, or some lesser

amount adequate to entice buyers to lift all the oil (i.e., "clear the market"). A ticket system could benefit the majors which may be politically unacceptable to the U.S., and would probably not be welcome by the Iranians who want liftings by companies other than the majors who are members of the consortium.

A "market" for rights to lift would be established in which tickets could be bought and sold or exchanged by holders not wishing to lift Iranian crude. In either of the two approaches mentioned above, a small refiner "set aside" could be arranged. In addition, length of contracts and quantities of rights to lift could be varied to meet market demands.

Legal Authority

There are two possible authorities for such purchases and resales:

1. Title III of the Defense Production Act; and

2. the Technical Purchase Authority of the Energy Policy and Conservation Act (EPCA).

Action under either would still require appropriations by Congress (and perhaps an authorization under the DPA if a revolving fund is used). Action under the Technical Purchase Authority would be subject to a one-House veto within 15 days of submission of the proposed regulations to the Congress.

If the Defense Production Act were used, the Government would have to relate the purchase to the relevant purposes of the DPA, and the necessary factual finding could be difficult to make and vulnerable in litigation. Congress has also indicated its general disfavor for an expanded use of the DPA. Findings under the Technical Purchase Authority would be considerably easier to make since the proposal is consistent with the intent of Congress in the EPCA.

Under the Technical Purchase Authority, it would be possible either to auction new oil or to allocate it on an input basis to all refiners as long as such allocation is done so as not to provide a "subsidy or preference to any importer, purchaser, or user." The DPA would require any oil to be resold at market prices, thus an auction or market sale would probably be required. The Technical Purchase Authority is the preferred option.

Purchasing Price

Under the terms of the proposal, the purchase price of oil sold by Iran to the USG would consist of two major elements:

1. A discount equivalent to normal credit terms available in the market. Since the USG would be paying for oil before the oil was resold, a price discount would be granted by Iran equivalent to 60 days credit (effective 75 days since normal contracts call for "60 days end of month"). The discount would be about 15 to 20 cents per barrel in today's market.

2. A negotiated discount of at least $1.00 per barrel, which would be fixed for the term of the contract.*

The Base Price, off which discounts would be granted, would be established at the beginning of the contract and relate to market price, not to the OPEC posted or buyback price. Price indexation related to U.S. wholesale index prices would be provided for. Under no circumstances would the Base Price be permitted to rise above market price. The discounts off Base Price, as adjusted, would remain firm.

USG Selling Price

Assuming the USG received a discount of $1.00 per barrel in addition to the credit discount, a determination of the amount necessary to clear the market must be made. It is assumed normal credit terms would be accorded U.S. companies by the USG. The USG would offer a discount in the range of 30 to 50 cents per barrel to companies in order to sell the oil. The U.S. market, excluding the majors, is sufficient to absorb 500 MB/D. If it is found that the market will not "clear" the oil, a deeper discount might be needed to entice majors into the

*State believes a firm discount above 50 cents is not negotiable.

marketplace. Majors would have economic and political problems with other producing countries if significant volumes were shifted from one country to another. It is, therefore, advisable to negotiate at least a $1.00 discount from Iran. This amount would also provide sufficient margin to cover USG administrative costs.

Length of contracts, individual credit terms and cargo lot sizes factors could all be accommodated within the marketplace through an auction system.

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THE WHITE HOUSE

WASHINGTON

January 14, 1976

MEMORANDUM FOR: JIM CONNOR

FROM: PHIL BUCHEN P.

SUBJECT: Frank G. Zarb memo 1/13/76 re: U. S. Government Oil Purchase Agreement

The last of the listed disadvantages is perhaps the most important. This would be a conspicuous, controversial action. If we cannot give a realistic explanation, the alternative rationales will look disingenuous.

An important disadvantage not listed is the major administrative problem created by resale of the oil. It presents the same problem that persisted for years in allocating oil import quotas. Auctioning was often proposed, but never proved politically acceptable. The politically inevitable preference for the smaller refiners would be a subsidy and a continuing source of controversy.

Another disadvantage is that this proposal is inconsistent with the President's policies for energy independence. The massive government intervention -- to obtain imports -- may be seriously resented by the domestic energy industry just at the time we are trying to encourage its expansion.

~~SECRET~~ (State Derivative)

B

MEMORANDUM

THE WHITE HOUSE 269-X

WASHINGTON

~~SECRET~~/SENSITIVE

January 17, 1976

MEMORANDUM FOR: JAMES CONNOR

FROM: BRENT SCOWCROFT

SUBJECT: U.S. Government Oil Purchase Agreement

In my view Frank Zarb's memo to the President fairly outlines the advantages and disadvantages of the proposed US-Iranian oil deal. I fully support the objectives of the proposed arrangement with Iran. However, while it may not be possible to conclude the arrangement immediately, I recommend that we press ahead as a matter of the highest priority to resolve the issues which we now find troublesome.

In addition, I strongly support Zarb's suggestion that we explore the possibility of entering into an oil purchase agreement to fill the strategic reserves, as mandated by the Energy Act. It is questionable, however, whether such an arrangement would weaken the ability of the OPEC cartel to unilaterally establish prices.

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THE WHITE HOUSE

WASHINGTON

January 6, 1976

MR. PRESIDENT:

Brent Scowcroft sent you an information memorandum (attached at Tab A) on the U.S. -Iran Oil Agreement. The basic thrust of Brent's memo is that an agreement would be worked out which would permit oil from government-to-government sales to flow directly into the private sector.

At Dick Cheney's suggestion, I copied Alan Greenspan and Frank Zarb on the memorandum. They favor a different approach entailing governmental purchases for stockpile purposes. Their initial comments are attached at Tab B.

They have discussed with approach with Charles Robinson of State Department, and they will be sending you further information on the subject on January 8th.

Jim Connor

Attachments (2)

JRC
Jim
Send later report back.

A

A

ITEM WITHDRAWAL SHEET
WITHDRAWAL ID 00592

Collection/Series/Folder ID No. ..... :	004700497
Reason for Withdrawal .... :	NS,National security restriction
Type of Material .... :	MEM,Memo(s)
Creator's Name .... :	Brent Scowcroft
Receiver's Name .... :	President
Description .... :	re U.S.-Iran oil agreement
Creation Date .... :	01/03/1976
Volume (pages) .... :	3
Date Withdrawn .... :	05/03/1988

A

DEPARTMENT OF STATE
WASHINGTON

SECRET/SENSITIVE

MEMORANDUM TO THE ASSISTANT TO THE PRESIDENT
FOR NATIONAL SECURITY AFFAIRS

Subject: Technical and Legal Feasibility of Proposed Bilateral Oil Agreement with Iran

As you requested, Bob Ellsworth and I have concerted views on the technical and legal aspects of a bilateral oil arrangement with Iran, as outlined to the President by Secretary Kissinger on December 19. While reserving the right of our respective Secretaries to comment on policy aspects of the proposal, we have agreed that the arrangement would be feasible if the key terms noted below were accepted by the Government of Iran.

A. Key Terms of Agreement

1. The Agreement would become operative upon the enactment of a U.S. appropriation under the Defense Production Act. This appropriation would need to be about $350 million, equal to the initial 60 days of purchases of Iranian crude under the Agreement, after which receipts from sales to refiners should regularly exceed outlays. (A DoD legal opinion now holds that authorizing legislation for the creation of a special revolving fund may be necessary. State disagrees. The issue will be reviewed urgently.)

2. Base prices would be established in the Agreement for Iranian light and heavy crude at prices currently competitive with the lowest current international market prices, taking into account quality and

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GDS

shipping factors, rather than presuming that the current Iranian selling prices are necessarily competitive. (The base prices so established would be fixed for the five years of the Agreement. We would seek agreement language making them subject to a continuing test of competitiveness.)

3. Limited indexing adjustments in established base prices would be provided for in the Agreement, commencing July 1, 1976 and at six-month intervals thereafter, in the same percentage as the U.S. Wholesale Price Index (for "all commodities") rises or falls in the preceding six months; provided, however, that the adjusted base prices could never exceed the then prevailing Iranian selling prices to other customers.

4. Price discounts of approximately 50 cents per barrel below the established and adjusted base prices would be fixed by the Agreement. The discounts would be in addition to the financial equivalent of the normal 45-day interest-free credit terms. (DOD's position is that we should negotiate as great a discount as possible. Ellsworth believes the discounts ought to be at least $1.00. I expect the total of fixed discount and likely price differentials under the Agreement as proposed to rise to $1.00 or more by next fall.)

5. Payment terms would be cash by DOD to the National Iranian Oil Company (NIOC) within 15 days of receipt by DOD of each monthly supply of NIOC crude oil contracts. (Payment terms on sales by DOD to U.S. refiners would be set after consultation with crude marketing specialists, but our present thinking is to provide a uniform 60-day interest-free deferral of payment, consisting of the normal 45 days plus an average 15 days between contracting and lifting of oil.)

The expected effect of the payment and price terms outlined above would be to guarantee against fiscal losses by DOD in operating the program. The fixed discount would always be free and clear and, hopefully, more than sufficient to induce refiners to buy the contracts.

(DOD believes the foregoing can only be demonstrated by a continuing test in the market place.) In addition, we expect the lags in semi-annual price adjustments and the differential between the adjusted prices and prevailing OPEC prices to yield a growing price advantage for the U.S. If the program works as expected, the only conceivable DOD "loss" would result from great success, that is, if the OPEC price front collapsed during a month after DOD had taken NIOC contracts at the formula price. Such a price collapse would yield great fiscal benefits to DOD, and great economic benefits to the U.S. economy generally, over the following months, so that no long-term loss would result.

B. Program Operations

-- The President delegates to the Secretary of Defense authority to carry out this program under the Defense Production Act and the supporting appropriation act.

-- NIOC issues to DOD at the first of each month (or quarterly, as may be agreed), special contacts (bearer or assignable) totalling 15 million barrels in conveniently denominated quantities of specified types of Iranian crude, in the most favorable ratio of heavy and light crude which is negotiable.

-- DOD draws on the revolving fund established by a special appropriation under the Defense Production Act to pay for these contracts at the Agreement formula prices then obtaining, within 15 days of receipt of the contracts from NIOC.

-- DOD or its agent auctions these contracts to U.S. companies operating refineries in the United States or operating offshore refineries certified by FEA to be substantially directed at serving the U.S. market. DOD, at its option, may retain all or part of the crude oil as "government-furnished material" for DOD use. (In the event the U.S. Government undertakes to supply oil or petroleum products to Israel or other countries under international security agreements, the restriction on refiners eligible to bid for the crude under this Agreement may be modified.) The payment terms offered by DOD to bidders probably will be cash 60 days after purchase of contracts, as explained in paragraph 5 (Payment Terms) above.

-- Receipts from sales are deposited in the revolving fund. Earned surplus is held in this account as a contingency fund against short-term losses.

-- Oil contracts not sold during any given periods are carried forward to subsequent period, up to a limit fixed in the Agreement. (We may seek a generous limit on carryovers in the initial months and accept a smaller limit thereafter.)

C. Other Technical Issues

A variable factor of major importance is the termination provision of the Agreement. Iran may want the right to terminate in the event it finds that this program is displacing its "regular" exports to the United States. If Iran insists on weakening our proposed provision for a continuing competitive price test (on the established and adjusted prices), we will have to compensate for this with a termination clause achieving much the same result. These and other elements of the Agreement are subject to trade-offs so long as the end result is an arrangement designed to achieve our policy objectives, as outlined by Secretary Kissinger on December 19, and to avoid net losses by DOD.

Charles W. Robinson

Charles W. Robinson
Acting Secretary

B

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

OFFICE OF THE ADMINISTRATOR

January 6, 1976

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB
ALAN GREENSPAN

Attached is a summary of our views related to bilateral transactions with oil producing countries.

We have reviewed the content with Charles Robinson. He has agreed to pursue further with us the concept raised on page 7, paragraph 2. That is the possibility of negotiating a 500 million barrels contract with Iran for the purpose of filling our strategic reserves. The basis for this transaction would be to negotiate a price well below market, i.e., \$7.50 and \$9.00 with the understanding that the oil purchased would not be permitted in the marketplace but rather committed to National storage.

We are preparing a separate paper to describe the mechanisms of such a transaction and will submit it by c.o.b. Thursday, January 8.

Attachment

THE WHITE HOUSE
WASHINGTON

Jim Conner

Have read.
Rather no action
proposed now.

Conner

THE WHITE HOUSE

WASHINGTON

January 22, 1976

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: FRANK ZARB

FROM: JIM CONNOR

SUBJECT: U.S. Government Oil Purchase Agreement

The President reviewed your memorandum of January 13 on the above subject and made the following notation:

"Have read. Gather no action proposed now."

cc: Dick Cheney
Brent Scowcroft

00595

~~SECRET~~ (State Derivative)

DISCUSSION PAPER

BILATERAL OIL AGREEMENTS

Issue

In recent months, a number of opportunities have developed for the U.S. Government to enter into bilateral oil purchase agreements with oil exporting governments. Iran, the UAE and the USSR are among identified partners.

The proposed agreements have evolved largely for political reasons. The purpose of this paper, however, is to address the economic and energy aspects of the agreements. More specifically: If the USG is to enter into serious negotiations for bilateral oil agreements, what are the economic and energy principles that should determine negotiating guidelines?

Background

The current interest in bilateral oil agreements is set against a background of weakened demand in the major consuming countries, reflecting depressed economic activity; and significant (25 to 30 percent) excess productive capacity in the major oil exporting countries (OPEC). A number of the producers (particularly Iran, Venezuela, Nigeria and Indonesia) have ambitious

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development plans, dependent on increased oil revenues, which are being placed in jeopardy. They might be interested, therefore, in bilateral agreements assuring offtake at fixed prices. Finally, the role traditionally played at the international oil industry is changing as governments, both producing and consuming, implement varying control measures. Consuming countries are also implementing supply development and demand conservation programs, but the immediate impact will be slight. At the same time, success in bilaterals might suggest relaxation in domestic plans which are aimed at reducing import dependence.

Potential Benefits and Problems

Proponents and opponents of bilateral oil agreements can identify a number of supporting factors on which they take opposing sides.

1. Economic Benefit - It is argued that if the USG were the sole importer or a substantial trader in meeting US demands, the size of the market would result in significant price competition by producer countries facing the loss of access to the United States market. Opponents suggest that the OPEC cartel can easily

function as a single seller. Moreover, the USG would enter into an activity, sole or significant oil importer, that has been traditionally and ably performed by private industry. The smooth functioning logistical system supplying hundreds of refineries around the world with the right crude at the right time, supplying product deficits and disposing of product surpluses, could not be duplicated in government efficiently.

2. Cartel Dissolution - Proponents of bilaterals suggest the temptation by OPEC nations "to cheat" to gain market share in the United States would undermine OPEC. Opponents suggest that the functioning of the cartel is really dependent on several key countries, principally Saudi Arabia, and that a sole buyer for the US market would alleviate rather than increase the problem of cartel maintenance. If, in addition, the USG were to include some sort of indexation provision as part of a bilateral agreement, OPEC countries would have achieved another of its objectives, escalating prices to maintain purchasing value of foreign exchange.

3. Embargo Protection - Proponents of bilaterals suggest that the United States would be insured against the economic impact of potential future embargoes.

Opponents, while granting that countries such as Venezuela, Indonesia, Nigeria and Iran maintained or increased exports to the US during the embargo of 1973-74, suggest that this type of insurance would require the US to "contract" virtually all of the exports of Venezuela, Indonesia and Nigeria, thereby tying the US to these countries. Greater security of supply can be had within the international oil system itself, where many buyers and sellers provide flexibility and diversity which would be denied in bilateral agreements.

<u>Options</u>

The existence of bilateral oil agreements places the United States Government or one of its instruments in the role of a major importer -- a role that easily may be expanded to one of monopoly importer. Proposals to achieve this end have been introduced in Congress and have achieved substantial support. Three possible approaches exist:

1. <u>Sole Importer</u> -- The Energy Policy and Conservation Act of 1975 (P.L. 94-516) provides the President with discretionary authority, with Congressional approval, to establish the USG as an oil importer, either exclusive or partial. A monopoly importer of oil would have unparalleled

power over the entire energy industry because at present, and for the forseeable future, imported oil is the marginal energy source. The price at which imports would be sold thus will set the domestic price of energy, and the quantity that is imported can determine whether shortages necessitating rationing will occur. A government agency would be under recurring pressure to use the leverage thus obtained to achieve by subterfuge or misdirection social goals which might not be accepted if presented forthrightly. The consequence would be a centralization of power, the use of which could lower economic welfare as well as pervert established governmental processes.

2. Selective Importer - The USG could, for its own account or for resale, conclude bilateral agreements with selected oil exporting countries. For reasons given above, however, pressures to move to sole importer status will be difficult to resist.

3. Industry Partnership - The USG could support, through means which may be identified in FEA's present investigation under the provisions of the Energy Act, industry in its attempts to import oil into the US at lower than prevailing prices. (This option has not been developed at this stage.)

Principles and Negotiating Guidelines

If the USG is to enter into serious bilateral oil negotiations, the following principles are suggested as negotiating guidelines:

1. Price - A significant discount -- say $2.00 per barrel -- is desired, either directly as a discount or "net" through credit, freight or other differential. The discount must be "visible", in order to exert maximum influence on OPEC members and to be accepted politically in the US.

2. Supply - If no significant price discount can be negotiated, no firm contract by the USG to lift should be entered into. If "competitive" price provisions are all that is attainable, an "option" to buy is all that the USG should agree to. Quantities contracted should not be so great that the United States becomes dependent upon just a few countries for such a vital resource. Countries outside of the Middle East, for political and transportation reasons, are probably preferred sources of supply.

3. Economic Benefit - The agreement should be of significant economic benefit to both parties. For example,

if Iran would agree to supply a substantial quantity of oil -- say, 500 MBD -- at a significantly reduced price -- say $7.50 per barrel -- the USG could agree to hold the oil as part of the strategic oil reserve instead of putting it on the market, except in the event of an embargo. The US would benefit obviously, and Iran would benefit from immediate revenue without disrupting the market.

4. Industry Relationship - So long as the USG is not the sole importer, US oil firms should not have to accept whatever terms the USG may agree to for their own purchases from the same suppliers.

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Hold for Jim Connor --

1/8/76

00596

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

OFFICE OF THE ADMINISTRATOR

December 20, 1975

Working group
Surface issues
Jan 6 deadline
State
DoD
NSC
FEA
CEA

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB
ALAN GREENSPAN

SUBJECT: SOVIET OIL NEGOTIATIONS

We have reviewed the negotiating parameters which could lead to a conclusion of an oil deal with the Soviet Union. Simply stated, our recommendations are as follows:

1) If an agreement is reached whereby the U.S. Government is to be a purchaser of Soviet oil for resale to U.S. consumers a Federal import authority would have to be created and implemented. That is, the U.S. Government would be the purchaser of oil and then have to sell entitlements of that oil to the industry. Since that represents a major departure in the current distribution method, we would object to such an arrangement unless the price discount was significant enough ($2.00 per barrel) to warrant it.

2) If the completed contract contemplates that Soviet oil at some discount is to be picked up by the U.S. Government for use by the Department of Defense, we can see no substantive objection. However, the appearance of our military forces being fueled by Soviet oil (no matter how indirect) may raise serious questions. Therefore, we would urge that the Secretary of Defense be consulted before approval of such an arrangement.

3) If the completed transaction contemplates private companies taking down the Soviet oil for redistribution at a modest discount we would ask for assurances that real or apparent favoritism among segments of the oil industry be avoided. These assurances would be difficult to construct, therefore we feel that kind of arrangement should be ruled out.

Opportunities for unilateral U.S. arrangements with producing countries will persist. We recommend that you arrange a brief meeting with the Secretary of State so that we can all have your clear direction with respect to the parameters of this for the Soviet, as well as subsequent negotiations.

00597

MEMORANDUM 7562

THE WHITE HOUSE

WASHINGTON

ACTION

December 9, 1975

MEMORANDUM FOR: THE PRESIDENT

FROM: BRENT SCOWCROFT

SUBJECT: Soviet Oil Negotiations

Secretary Kissinger's memorandum (Tab A) requests your approval of a negotiating plan to reach a long-term oil agreement with the Soviets.

The letter of understanding signed by Chuck Robinson in Moscow in October established the outline for an oil agreement:

-- The Soviets to offer the US, for a five-year period, 10 million metric tons of crude oil and petroleum products annually.

-- The USG may purchase the crude and products for its own use; or, by agreement of the parties, the purchase may be made by US firms.

-- Roughly 70% of the total quantity offered for sale will be crude.

-- Some portion of the crude or products will be shipped to the US, partly in tankers used to transport grain from the US to the USSR; some portion may be delivered to Europe or other marketing areas.

-- Prices will be mutually agreed at a level which will "assure the interests" of both the USG and the USSR.

The negotiating plan recommended by Secretary Kissinger to effect this agreement calls for:

-- Trying to establish favorable prices for both the US government and for US private firms wishing to buy from the Soviets; we recognize that we may have to give up insistence on favorable price treatment for firms.

-- Giving the US negotiator (who will report continuously and directly to Secretary Kissinger) tactical flexibility; it would be understood that any major change from what is now agreed among the key US principals will be discussed with them and, if necessary, referred to you for decision.

Bill Seidman, Frank Zarb, and Alan Greenspan concur in this negotiating plan.

Recommendation:

That you approve Secretary Kissinger's recommended line of action.

Approve ___HRF___ Disapprove ___________

A

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S/S 7522679

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THE SECRETARY OF STATE

WASHINGTON

~~CONFIDENTIAL~~

November 13, 1975

MEMORANDUM FOR: THE PRESIDENT

From: Henry A. Kissinger HK

Subject: Soviet Oil Negotiations

When you announced on October 20, 1975 the conclusion of a long-term grain agreement with the Soviet Union, you also announced that negotiations of an oil agreement would proceed promptly on the basis of the attached letter of intent signed in Moscow by Under Secretary Robinson and Minister Patolichov.

The State Department chaired an inter-agency working group to prepare for the next round of talks. Its report is attached. Bill Seidman, Frank Zarb, and Alan Greenspan have examined the attached options and concurred with the State Department that our objective should be an Agreement with a price clause sufficient for oil and petroleum products to be purchased on a favorable basis.

In essence the recommended negotiating plan is:

-- To try to establish favorable prices for optional purchases for both the U.S. Government and for Private U.S. firms, while recognizing that we may have to give up on the price issue for private firms.

-- To renew negotiations on the basis of the draft Agreement attached to the Working Group Report.

~~CONFIDENTIAL~~

-- To authorize tactical flexibility for the negotiator, who will report continuously and directly to me, with it being understood that any major change from what is contemplated herein will be discussed with the other Principals involved and, if necessary, referred to you for decision.

Recommendation:

That you approve this line of action.

Approve /NK/ Disapprove ____________

Attachments:

1. Letter of Intent.

2. Inter-Agency Working Group Report.

3. Options.

His Excellency
N. S. Patolichev
Minister of Foreign Trade
Moscow, U.S.S.R.

Dear Mr. Minister:

This is to confirm the understanding arising out of our discussions that our two Governments intend to commence negotiation promptly to conclude an Agreement concerning the purchase and shipment of Soviet oil. This Agreement will provide for the following:

(1) The Government of the Union of Soviet Socialist Republics will, for a period of five years, offer for sale annually ten million metric tons of crude oil and petroleum products.

(2) The Government of the United States may purchase the crude oil and petroleum products for its own use or, by the agreement of the Parties, the purchase of crude oil and petroleum products may be made by United States' firms.

(3) About 70 percent of the total quantity offered for sale will be crude oil. The remainder may be petroleum products, in particular diesel oil and naphtha.

(4) Some portion of the crude oil or petroleum products will be shipped to the United States, partly in tankers used to transport grain from the United States to the Soviet Union.

(5) Some portion of the crude oil or petroleum products may be delivered to Europe or other agreed marketing areas.

(6) Prices for crude oil and petroleum products will be mutually agreed at a level which will assure the interests of both the Government of the United States and the Government of the Union of Soviet Socialist Republics.

In addition it is further understood that both Governments will work for the extension and expansion of the cooperative efforts already underway in the field of energy. Such efforts will be particularly directed toward the fuller application of the technological capability of both countries in increasing energy output from existing sources and in developing new sources of energy.

Sincerely yours,

Charles W. Robinson
Under Secretary of State
for Economic Affairs

00600

DEPARTMENT OF STATE

Washington, D.C. 20520

~~CONFIDENTIAL~~

November 5, 1975

MEMORANDUM FOR: MR. ROBINSON

FROM: Deane R. Hinton

SUBJECT: Soviet Oil Negotiations: Working Group Status Report

The full working group* that you asked me to constitute has concurred in the following report:

1. Objectives

We considered four optional objectives:

(a) An agreement with a large and obvious price discount;

(b) An agreement with a price clause sufficient to provide for oil and products to be purchased on a favorable basis;

(c) A framework oil agreement with price to be negotiated both by the Government and private companies at the time of any actual purchase;

(d) An approach to the oil agreement designed to let the whole idea gradually fade away.

We concluded that option (a) was not negotiable and that option (d) was undesirable.** Accordingly, the group recommends (FEA hesitantly) trying for option (b) leaving open the possibility that, in the end, we will do no better than option (c).

---

*State: C - Mr. Shinn
L - Mr. Trimble
EUR - Messrs. Armitage and Edgar
EB - Messrs. Bosworth and Raicht
S/P - Mr. Ely
FEA: Messrs. Conant, Bell and Malin
MARAD: Mr. Howard Casey
CEA: Mr. Russell

** Mr. Conant reserved right to differ, and I observed that each of our respective principals had that right.

R. FORD

2. Price Option

There are two sub-options to option (b), our preferred starting position:

(a) The price to be negotiated could apply to sales made both to the USG and US nationals.

(b) It might apply only for sales made to the USG.

Since a draft side letter presented to the Soviets in Moscow indicated our willingness in some circumstances to establish price in the agreement only for the USG leaving private nationals to establish price in commercial contracts, we think it unlikely that the Soviets would give us a definite price advantage in the agreement for both the Government and private firms. Moreover, a relatively large price discount paradoxically would present problems for us since it might make it necessary to create a mechanism to recapture windfall profits from private companies and might otherwise make the Government an intermediary in the private market. Nevertheless, it is our judgment that it is worth trying the B-(a) option, since we can always fall back to a price negotiation just for the USG. While the FEA representative initially agreed with this line of reasoning he is not enthusiastic. He also pointed out that this was a particularly sensitive point needing consideration by principals.

3. Freight Rates

The group recognizes the critical relationship between what is done about oil in the negotiations currently underway for renewal of the Maritime Agreement and what may be possible in the oil agreement itself. As you know, a good place to conceal a discount on oil is by transportation rates.

The present position for the maritime talks is that oil and other bulk cargoes, except grain, should move at market rates. From many points of view, market rates for tankers hauling oil from the Black Sea to the U.S. would be desirable. Moreover, this is the easiest option to negotiate. Paradoxically however, there are reasons why, in certain circumstances, one would prefer above market rates for these oil shipments. It is conceivable, for example, that the Soviets would agree to a lower f.o.b. Black Sea oil price were the freight rate higher. It is also possible that they won't agree, but we have to assume something until we learn better. If the Soviets accept the basic point that the c.i.f. price of their oil in American ports must be competitive with the Saudi marker crude plus freight to the same port, it follows that, using a higher than market freight rate from the Black Sea to American ports would produce, when netted back, a lower "discount" f.o.b. Black Sea oil price.

The group noted that the present pattern of freight rates, i.e., depressed VLCC rates of roughly World Scale 15-20 and fairly favorable Black Sea Gulf rates for 50,000 ton tankers of roughly World Scale 80-100, favors the U.S. oil price objective. Thus, if an F.O.B. Black Sea oil price can be established on this basis, it would probably be desirable for future price fluctuations to be tied only to Saudi Arabian marker crude prices (or another oil price index) rather than to a more complicated formula also incorporating freight rates. That is, if we can get agreement on the present transportation differential, we should probably seek to keep this number a constant over the five year period.

We agreed that the ideal solution would be market tanker rates -- assuming, as MARAD data indicates is presently the case, they are sufficient to cover incremental costs, including cleaning charges -- for moving any actual oil shipments while computing the f.o.b. oil price by using a phantom freight rate which would be above market. We think that, while not impossible, it is unlikely that the Soviets would agree to such a procedure. If we can't have a phantom rate for pricing purposes and a market rate for transportation purposes we are forced to consider the possibility of real premium tanker rates. On the face of it, this is an absurd proposition. It would mean that the USG, were it to buy Soviet oil, would pay higher than market rates not only to American ships but also to Soviet tankers. Still, if it were acceptable to the Soviets and were it, in fact, to result in a lower f.o.b. oil price it could be defended as providing net benefits to the U.S. taxpayer.

As far as the Soviets are concerned, premium tanker rates would change the division of Soviet earnings between their maritime freight and their oil export organizations, but would not change the c.i.f. price for the oil into the U.S.

As far as we are concerned, as long as we can devise a subsidy abatement formula to recapture the premium above market paid to American freight vessels, it would be a "wash" operation for the Maritime Administration and the Treasury that would result in a discount of 50% of the premium freight rate from the real c.i.f. price for Soviet oil.* It is to be noted, however, that if freight rates for hauling grain were in the $27-30 a ton range or over there would be no subsidy to recapture, and the U.S. taxpayers would be providing an additional unjustified benefit to U.S. shipowners, as well as to Soviet ships.

There is an additional conceivable benefit to us from such a system in that it would increase transportation differential profits for the USG were it to move Soviet oil to Europe rather than the U.S., swapping an equivalent amount of oil from US oil companies for delivery to the States. This potential benefit would come from savings on freight paid Soviet vessels, not subsidized US vessels. However, it would only be realizable if the USG actually engaged in commercial oil transactions and, as of now, the FEA and the CEA are deadset against that.

We concluded that there were three options:

(a) Market freight rates for oil;

(b) Market freight rates for oil, unless otherwise agreed by the designated Maritime negotiations;

(c) Mutually agreed tanker rates for oil.

The FEA representatives preferred option (b) but eventually agreed to option (c) with the understanding that, unless rates are agreed before the Maritime Agreement is actually signed side letters would be exchanged saying that market rates would be used until agreement on another rate were reached. The advantage of option (c) is that it gives us time to explore with the Soviets both whether phantom rates are possible, and the chance that we can get a favorable oil price by manipulating tanker rates. The worst possible result, of course, would be an agreement on premium tanker rates without any agreement on oil prices.

*The market rates plus $4.00 a ton on this hypothesis would yield a $2.00 a ton discount or just under 30¢ a barrel.

We assume -- and I hope this is right -- that we can always reach option (a) or (b) if, in the light of more knowledge, that proved to be desirable.

It is also to be noted that, unless price for private companies is settled in the Agreement, the case for market tanker rates is virtually conclusive.

4. Controlled Cargo

The controlled cargo issue with respect to oil is another esoteric matter but one of significance. FEA argues strongly (and convincingly, to me) that private US nationals or companies buying oil f.o.b. from the Soviet Union should have complete flexibility concerning shipping arrangements. The Maritime Administration is opposed, however, to any such exception for oil from the controlled cargo principle. MARAD recognizes that, in all likelihood, American tankers already in the Black Sea because they carry grain would have a competitive advantage and that, therefore, most of any oil business would go to them. Nevertheless, MARAD and EUR argue that even though there might be real advantages to excluding Soviet oil bought f.o.b. by American private companies both from the controlled cargo and from the accountability principle, the danger of weakening the basic principle underlying the Agreement is too great to justify an exception from the rule.

On the other hand, there is some risk that a high proportion of oil carried in US flag vessels could mean less grain in US vessels. This point requires further analysis, which MARAD is undertaking.

Much of the analytical difficulty in reaching clean recommendations concerning the tanker rate and controlled cargo issues is traceable to uncertainties not only as to what might happen over a five year period but also to what is possible on oil with the Soviets. Were a clear picture to emerge of the oil deal to be had, it would make it much easier to reach agreement on a negotiating position for MARAD. In these circumstances, it would perhaps be well to reexamine the situation just before renewal of the Maritime Agreement negotiations, now scheduled for early December, in the light of what has or has not by then been achieved on oil.

5. Technology

FEA has strong reservations about providing a green light in the oil agreement to American companies to provide the Soviets technology to improve their oil production capacity. I explained that you had made clear that this was a matter which would be considered in a follow-on agreement to the oil sales agreement. Thus, it would not be an issue in these negotiations unless the Soviets pushed hard for something on technology now. We agreed that our position should remain, as you have stated it: The oil purchase agreement should be concluded as such, and the technology issue deferred for a subsequent agreement with the Soviets. If the Soviets pursue the point, we will resist and only request Principals to reexamine the position if it becomes evident that the only way we can get a meaningful oil price discount is through some give on technology.

6. Draft Agreement

The working group has approved the attached draft agreement as a basis for renewing negotiations with the Soviets, if Principals elect to pursue Option B. It is understood that, were principals to prefer an option other than option (b) the draft agreement would have to be reworked to accord with their views. The draft also provides language compatible with either sub-option (b) (1) or sub-option (b) (2), but as noted in Section 2 above, the group -- FEA hesitantly -- recommends renewing negotiations on the basis of seeking a negotiated price both for the USG and private companies.

7. Tactics

The group believes that it would be desirable to try to reach agreement with the Soviets on all Articles of the Agreement other than price leaving the price question for the final stages of the negotiation. It further believes that an attempt should be made to draw the Soviets out on their views on price and how an f.o.b. price might be calculated before setting forth in detail our views. Finally, the group has reviewed and approved a number of price article variants attached at Tab 2 with the intent that the negotiating team could draw on that work at the appropriate time. While it is the group's belief that price should be left for last, it was also recognized that the deadline for completion of the separate agreement on maritime matters of December 31, 1975 might require the negotiators to raise the price issue before all other matters were resolved. The most important conclusion of the group was that the negotiating team should have tactical flexibility to act in accordance with the overall plan approved by principals and within the limits of that plan to advance positions to meet and to respond to the evolving negotiating situation and Soviet views.

8. Recommendation

It is recommended that you approve this paper as the basis for renewing negotiations and that you circulate it to Secretary Kissinger, Secretary Morton, Assistant to the President Seidman, FEA Administrator Zarb, and Chairman of the Council of Economic Advisers Greenspan for concurrence or comment.

Attachments

Tab A - Memorandum from FEA to Ambassador Hinton, Subject: Draft Pricing Language, dtd Oct. 28, 1975

Tab B - Long-Term Agreement Between the US A and USSR Concerning Crude Oil and Petroleum Products (Draft, November 5, 1975)

OPTIONS

Option A: An agreement with a large and obvious price discount.

Pro: Most useful form of agreement both economically and politically.

Con: Not negotiable.

Option B: An agreement with a price clause sufficient to provide for oil and products to be purchased on a favorable basis.

Pro: Next most useful form of agreement politically and economically.

Con: Puts the government into the oil business at least as a negotiating intermediary.

Sub-option 1: Price clause for both USG and U.S. nationals.

Pro: Maximizes use of government leverage in dealing with state trading economy.

Con: May not be negotiable.

Prominent USG role as intermediary.

Sub-option 2: Price clause only for USG; nationals negotiate price separately.

Pros and cons reversed from sub-option 1. Also avoids windfall profit problem.

Option C: A framework oil agreement with price to be negotiated both by the government and private companies at the time of any actual purchase.

Pro: More easily negotiated.

Commercial matters left to be handled on commercial basis.

Con: Cop-out on price issue.

Subject to attack as meaningless agreement.

OPTIONS - (Contd)

Option D: An approach to the oil agreement designed to let the whole idea gradually fade away.

Pro: Avoids issues about government role, price, profits, etc.

Con: Loss of President's credibility and loss of option on oil.

THE WHITE HOUSE

WASHINGTON

January 22, 1976

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: FRANK ZARB

FROM: JIM CONNOR

SUBJECT: U.S. Government Oil Purchase Agreement

The President reviewed your memorandum of January 13 on the above subject and made the following notation:

"Have read. Gather no action proposed now."

cc: Dick Cheney
Brent Scowcroft

THE WHITE HOUSE

WASHINGTON

January 17, 1976

MR. PRESIDENT:

Re: U.S. Government Oil Purchase Agreement

The attached memo from Frank Zarb has been staffed to Phil Buchen, Jack Marsh, Brent Scowcroft, Bill Seidman and Jim Lynn and has elicited the following comments:

Jack Marsh --	Support FEA
Bill Seidman --	Agree with FEA -- discount too small and indexation feature is very bad.
Phil Buchen --	See detailed comments at Tab A
Brent Scowcroft --	[redacted] (see detailed comments at Tab B)
Jim Lynn --	Concurs with FEA

Jim Connor

ITEM WITHDRAWAL SHEET
WITHDRAWAL ID 00601

Collection/Series/Folder ID No.	:	004700497
Reason for Withdrawal	:	NS,National security restriction
Type of Material	:	MEM,Memo(s)
Creator's Name	:	Frank Zarb
Receiver's Name	:	President
Description	:	re oil purchase agreement
Creation Date	:	01/13/1976
Volume (pages)	:	3
Date Withdrawn	:	05/03/1988

00602

~~SECRET~~ (State Derivative)

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

January 13, 1976

OFFICE OF THE ADMINISTRATOR

MEMORANDUM FOR THE PRESIDENT

FROM: Frank G. Zarb

SUBJECT: U.S. Government Oil Purchase Agreement

Proposal

The USG has the opportunity to negotiate with Iran an agreement for the purchase of 500 MB/D of crude oil for a period of five years, at prices below OPEC levels and with price adjustments tied to changes in the U.S. wholesale price index. The State Department proposes to negotiate for a firm discount of at least 50 cents per barrel with further savings anticipated on periodic price adjustments. Defense and FEA believe a firm discount of at least $1.00 per barrel is necessary to minimize the risk of short-term loss by the USG in reselling the oil. Iran's interest in the agreement reflects anticipated financing difficulties in meeting its development and military needs and the low level of demand for Iranian crude in the currently depressed market.

Mechanics

The USG would purchase the oil directly from Iran and resell it to U.S. companies for delivery to the U.S. The Technical Purchasing Authority (TPA) provision of the Energy Policy and Conservation Act (EPCA) would provide enabling legislation, although the required appropriations legislation would be enacted only after the Congress had the chance to review the proposal. (A more detailed paper developing the mechanics of the proposal is attached.)

Advantages and Disadvantages of Proposal

The principal advantages of the proposal identified by the interested agencies are essentially international and political.

DECLASSIFIED
AUTHORITY RAC NLF-PHF-4-8-11-4 5/5/08
State guidelines
BY lih NARA, DATE 11/18/09

~~SECRET~~ (State Derivative)

. The relationship between the U.S. and Iran would be strengthened, and a possible severe cutback in Iranian purchases of U.S. military equipment and industrial goods could be averted.

. A measure of instability would be introduced into the international oil market by Iran's violation of OPEC agreements, and the doubling of Iran's share of the U.S. market at the expense of other OPEC countries. These factors could weaken the OPEC cartel's ability to unilaterally establish prices and production levels.

. The U.S. would switch about 8 percent of its oil imports to a cheaper and a politically more secure (i.e., non-Arab) source. An estimated annual savings of $180 million--assuming an average $1.00 per barrel discount--versus a total import oil bill of over $28 billion would result.

The principal disadvantages of the proposal identified by Defense, CEA and FEA focus on the energy and economic aspects and the domestic political implications.

. Involving the USG in the business of buying and selling oil would encourage those proponents of greater governmental involvement in the oil industry generally and of nationalization of imports more specifically.

. The amount of savings to be gained is not significant and the benefits to consumers would not be identifiable.

. The 500 MB/D lifted from Iran would displace some liftings from Saudi Arabia, which probably would threaten the US/Saudi relationship.

. The size of the discount would not significantly undermine OPEC's strength, and the indexation feature would represent an unfortunate precedent, not only with respect to Iran, but also with respect to other oil producers and raw materials exporters in general.

. The market and revenue pressures on Iran that have caused Iran to seek a bilateral agreement with the U.S. represent precisely the OPEC vulnerability to market forces that consuming countries are trying to encourage.

. The nature of the advantages preclude their being discussed publicly with Congress, either because of the political sensitivity of the issue or because the economic advantage would not be deemed to be significant.

Consideration of a Possible Alternative

If it is decided not to pursue the proposal currently under consideration, the possibility of entering into a sizable oil purchase agreement to fill the strategic reserves mandated by the EPCA may warrant consideration. Since the USG, under such an arrangement could commit the oil to reserves and therefore obviate any market impact, a potential supplier might consider a deep enough discount, providing sufficient economic benefit, to override domestic political considerations. Such a proposal could be evaluated in the context of the Early Storage Program and the Strategic Storage Program presently being developed in the Federal Energy Administration.

Conclusion

State discounts some of the disadvantages outlined above, but joins Defense, CEA and FEA in concluding that a decision to proceed with the proposal should be deferred for further evaluation of the likely responses of the oil market and of the Congress.

DISCUSSION PAPER

MECHANICS OF OIL PURCHASE AGREEMENT

Basic Assumptions

The USG will purchase from Iran for a period of five years 500 MB/D of crude oil. The USG will resell the oil F.O.B. Persian Gulf, in the form of "rights to lift" to U.S. companies operating refineries in the U.S. or at offshore locations with the resultant product destined for the U.S.

Mechanics

A basic contract between the Governments of Iran and the United States would commit Iran to sell and the USG to buy 500 MB/D of crude oil (light and heavy) for a period of five years. On a monthly basis, or for longer periods if desired by the USG, rights to lift would be issued by Iran which would in turn be sold by the USG to American companies. The USG would not physically possess the oil at any time. Transfers to U.S. companies would be effected F.O.B. Persian Gulf. The USG would pay Iran on a monthly basis for the basic amount contracted. Special arrangements would be made for the "start-up" period.

The USG has two basic options in transferring the rights to lift to U.S. companies.

1. An auction could be held by the USG of the rights to lift at the prices contracted between Iran and the USG. Potential buyers would submit bids reflecting their determination of the value of the particular rights. An auction provides a market test and is the preferred option.

2. Tickets may be issued or sold to all U.S. refiners/importers in proportion to refinery runs or imports in the total amount of 500 MB/D. Tickets would entitle the holder to purchase the available crude at prices determined by the USG, either the full amount of the discount received from Iran, or some lesser

amount adequate to entice buyers to lift all the oil (i.e., "clear the market"). A ticket system could benefit the majors which may be politically unacceptable to the U.S., and would probably not be welcome by the Iranians who want liftings by companies other than the majors who are members of the consortium.

A "market" for rights to lift would be established in which tickets could be bought and sold or exchanged by holders not wishing to lift Iranian crude. In either of the two approaches mentioned above, a small refiner "set aside" could be arranged. In addition, length of contracts and quantities of rights to lift could be varied to meet market demands.

Legal Authority

There are two possible authorities for such purchases and resales:

1. Title III of the Defense Production Act; and

2. the Technical Purchase Authority of the Energy Policy and Conservation Act (EPCA).

Action under either would still require appropriations by Congress (and perhaps an authorization under the DPA if a revolving fund is used). Action under the Technical Purchase Authority would be subject to a one-House veto within 15 days of submission of the proposed regulations to the Congress.

If the Defense Production Act were used, the Government would have to relate the purchase to the relevant purposes of the DPA, and the necessary factual finding could be difficult to make and vulnerable in litigation. Congress has also indicated its general disfavor for an expanded use of the DPA. Findings under the Technical Purchase Authority would be considerably easier to make since the proposal is consistent with the intent of Congress in the EPCA.

Under the Technical Purchase Authority, it would be possible either to auction new oil or to allocate it on an input basis to all refiners as long as such allocation is done so as not to provide a "subsidy or preference to any importer, purchaser, or user." The DPA would require any oil to be resold at market prices, thus an auction or market sale would probably be required. The Technical Purchase Authority is the preferred option.

Purchasing Price

Under the terms of the proposal, the purchase price of oil sold by Iran to the USG would consist of two major elements:

1. A discount equivalent to normal credit terms available in the market. Since the USG would be paying for oil before the oil was resold, a price discount would be granted by Iran equivalent to 60 days credit (effective 75 days since normal contracts call for "60 days end of month"). The discount would be about 15 to 20 cents per barrel in today's market.

2. A negotiated discount of at least $1.00 per barrel, which would be fixed for the term of the contract.*

The Base Price, off which discounts would be granted, would be established at the beginning of the contract and relate to market price, not to the OPEC posted or buyback price. Price indexation related to U.S. wholesale index prices would be provided for. Under no circumstances would the Base Price be permitted to rise above market price. The discounts off Base Price, as adjusted, would remain firm.

USG Selling Price

Assuming the USG received a discount of $1.00 per barrel in addition to the credit discount, a determination of the amount necessary to clear the market must be made. It is assumed normal credit terms would be accorded U.S. companies by the USG. The USG would offer a discount in the range of 30 to 50 cents per barrel to companies in order to sell the oil. The U.S. market, excluding the majors, is sufficient to absorb 500 MB/D. If it is found that the market will not "clear" the oil, a deeper discount might be needed to entice majors into the

*State believes a firm discount above 50 cents is not negotiable.

marketplace. Majors would have economic and political problems with other producing countries if significant volumes were shifted from one country to another. It is, therefore, advisable to negotiate at least a $1.00 discount from Iran. This amount would also provide sufficient margin to cover USG administrative costs.

Length of contracts, individual credit terms and cargo lot sizes factors could all be accommodated within the marketplace through an auction system.

~~SECRET~~ (State Derivative)

THE WHITE HOUSE

WASHINGTON

January 14, 1976

MEMORANDUM FOR: JIM CONNOR

FROM: PHIL BUCHEN P.

SUBJECT: Frank G. Zarb memo 1/13/76 re: U. S. Government Oil Purchase Agreement

The last of the listed disadvantages is perhaps the most important. This would be a conspicuous, controversial action. If we cannot give a realistic explanation, the alternative rationales will look disingenuous.

An important disadvantage not listed is the major administrative problem created by resale of the oil. It presents the same problem that persisted for years in allocating oil import quotas. Auctioning was often proposed, but never proved politically acceptable. The politically inevitable preference for the smaller refiners would be a subsidy and a continuing source of controversy.

Another disadvantage is that this proposal is inconsistent with the President's policies for energy independence. The massive government intervention -- to obtain imports -- may be seriously resented by the domestic energy industry just at the time we are trying to encourage its expansion.

~~SECRET~~ (State Derivative)

00604

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

269-X

~~SECRET~~/SENSITIVE

January 17, 1976

MEMORANDUM FOR: JAMES CONNOR

FROM: BRENT SCOWCROFT BS

SUBJECT: U.S. Government Oil Purchase Agreement

In my view Frank Zarb's memo to the President fairly outlines the advantages and disadvantages of the proposed US-Iranian oil deal. I fully support the objectives of the proposed arrangement with Iran. However, while it may not be possible to conclude the arrangement immediately, I recommend that we press ahead as a matter of the highest priority to resolve the issues which we now find troublesome.

In addition, I strongly support Zarb's suggestion that we explore the possibility of entering into an oil purchase agreement to fill the strategic reserves, as mandated by the Energy Act. It is questionable, however, whether such an arrangement would weaken the ability of the OPEC cartel to unilaterally establish prices.

~~SECRET~~/SENSITIVE

STAFFING

~~SECRET~~ -- EXCLUSIVELY
EYES ONLY

ACTION MEMORANDUM

THE WHITE HOUSE

WASHINGTON

LOG NO.:

Date: January 13, 1976

Time:

FOR ACTION:

Philip Buchen
Jack Marsh
Brent Scowcroft
Bill Seidman
James Lynn

cc (for information):

FROM THE STAFF SECRETARY

DUE: Date: January 15, 1976 Time: 3 P.M.

SUBJECT:

Frank G. Zarb memo 1/13/76
re: U.S. Government Oil Purchase Agreement

ACTION REQUESTED:

___ For Necessary Action

X For Your Recommendations

___ Prepare Agenda and Brief

___ Draft Reply

X For Your Comments

___ Draft Remarks

REMARKS:

We repeat this is: SECRET - EXCLUIV
EYES ONLY

Seidman - see comments
Marsh - supports FEA
Lynn - concurs with FEA
Scowcroft - support FEA

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

James E. Connor
For the Pres.

THE WHITE HOUSE

WASHINGTON

January 14, 1976

~~SECRET~~
EXCLUSIVELY EYES ONLY

MEMORANDUM FOR: PHILIP BUCHEN
JACK MARSH
BRENT SCOWCROFT
BILL SEIDMAN
JIM LYNN

FROM: JIM CONNOR

SUBJECT: U.S. Government Oil Purchase Agreement

Please refer to Frank Zarb's memorandum of January 13, 1976 on the above subject sent to you for comments last evening. For your information, Frank Zarb has requested that the concluding paragraph of his letter be changed to read as follows:

Conclusion:

State discounts the disadvantages outlined above and argues that the advantages far outweigh them. However, in view of the positions taken by Defense, CEA and FEA, State accepts their conclusion that a decision on the proposal should be deferred for further evaluation of the likely responses of the oil market and of the Congress.

Conculsion

State discounts the disadvantages outlined above and argues that the advantages far outweigh them. However, in view of the positions taken by Defense, CEA and FEA, State accepts their conculsion that a decision on the proposal should be deferred for further evaluation of the likely responses of the oil market and of the Congress.

asked Peggy to send us a revised 3rd page.

Date: 1/14/76

Office of the Administrator

SECRET

To: Trudy:

Here's the third page
of the Memo to the President
dated yesterday that
Mr. Zarb sent to the
him.

Thanks.

Federal Energy Administration

Room 3400 Ext. 6081

. The nature of the advantages preclude their being discussed publicly with Congress, either because of the political sensitivity of the issue or because the economic advantage would not be deemed to be significant.

Consideration of a Possible Alternative

If it is decided not to pursue the proposal currently under consideration, the possibility of entering into a sizable oil purchase agreement to fill the strategic reserves mandated by the EPCA may warrant consideration. Since the USG, under such an arrangement could commit the oil to reserves and therefore obviate any market impact, a potential supplier might consider a deep enough discount, providing sufficient economic benefit, to override domestic political considerations. Such a proposal could be evaluated in the context of the Early Storage Program and the Strategic Storage Program presently being developed in the Federal Energy Administration.

Conclusion

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old
page 3

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Conclusion

State discounts some of the disadvantages outlined above, but joins Defense, CEA and FEA in concluding that a decision to proceed with the proposal should be deferred for further evaluation of the likely responses of the oil market and of the Congress.

JAN 14 1976

THE WHITE HOUSE

WASHINGTON

January 14, 1976

~~SECRET~~
EXCLUSIVELY EYES ONLY

MEMORANDUM FOR: PHILIP BUCHEN
JACK MARSH
BRENT SCOWCROFT
BILL SEIDMAN
JIM LYNN

FROM: JIM CONNOR

SUBJECT: U.S. Government Oil Purchase Agreement

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E.O. [illegible] 3.3
By [illegible] NARA, Date 9/11/12

✓ Support FEA – JM

~~SECRET~~ -- EXCLUSIVELY
EYES ONLY
ACTION MEMORANDUM

THE WHITE HOUSE

WASHINGTON

JAN 14 1976

LOG NO.:

Date: January 13, 1976

Time:

due: 1/15
3:00

FOR ACTION:
Philip Buchen
Jack Marsh
Brent Scowcroft
Bill Seidman
James Lynn

cc (for information):

FROM THE STAFF SECRETARY

DUE: Date: January 15, 1976 Time: 3 P.M.

SUBJECT:

Frank G. Zarb memo 1/13/76
re: U.S. Government Oil Purchase Agreement

ACTION REQUESTED:

___ For Necessary Action

X For Your Recommendations

___ Prepare Agenda and Brief

___ Draft Reply

X For Your Comments

___ Draft Remarks

REMARKS:

We repeat this is: SECRET -
EYES ONLY

Support
FEA
JM

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

James E. Connor
For the President

~~SE~~ -- EXCLUSIVELY
EYES ONLY
ACTION MEMORANDUM

THE WHITE HOUSE

WASHINGTON

LOG NO.:

Date: January 13, 1976

Time:

FOR ACTION:
Philip Buchen
Jack Marsh
Brent Scowcroft
Bill Seidman
James Lynn

cc (for information):

FROM THE STAFF SECRETARY

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____ Draft Reply

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____ Draft Remarks

REMARKS:

We repeat this is: SECRET - EYES ONLY

Agree with FEA - discount too small and indexation feature is very bad.

LWS

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James E. Connor
For the President

~~SECRET~~ -- EXCLUSIVELY EYES ONLY
ACTION MEMORANDUM

THE WHITE HOUSE

WASHINGTON

LOG NO.:

Staff copy back to Scowcroft

Date: January 13, 1976

Time:

FOR ACTION:
Philip Buchen
Jack Marsh
Brent Scowcroft
Bill Seidman
James Lynn

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X For Your Comments	____ Draft Remarks

REMARKS:

We repeat this is: SECRET - EYES ONLY

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James E. Connor
For the President

Jim -

Any objection to sending a copy of memo to Zarb to Scowcroft?

Trudy