The original documents are located in Box 2, folder: "Memoranda to the President, December 12-31, 1975" of the Frank Zarb Papers at the Gerald R. Ford Presidential Library.

[Ca 12/12/75]

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

OFFICE OF THE ADMINISTRATOR

12/12/75 ?

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB

SUBJECT: H.R. 7014/S.622: The Energy Policy and Conservation Act

The Committee Report on the Energy Policy and Conservation Act (H.R. 7014/S.622) is now completed and is being filed today. Although floor action on the bill will probably not occur until Friday, December 12, we have sufficient information on the bill to evaluate its provisions and obtain the views of your advisors.

In evaluating the desirability of signing this bill into law, four factors should be considered:

- The acceptability of the pricing provision.
- The impacts of the legislation on your energy and economic goals.
- Reactions to the legislation and likely events if it is vetoed or signed.
- Other major elements of the bill and their desirability.

These evaluations and the views of your advisors are contained in this memorandum as follows:

PART I: Analysis of Pricing Provision

- TAB A: Description of the Pricing Provision
- TAB B: Comparative Price Scenarios
- TAB C: Energy Impacts of Alternative Price Scenarios

- TAB D: Economic Impacts of Alternative Scenarios
- TAB E: Ability of Provision to Lead to Decontrol
- TAB F: Alternatives if S. 622 is Vetoed
- TAB G: General Conclusions
- TAB H: Reasons to Reject Conference Bill
- TAB I: Reasons to Accept Conference Bill

PART II: Analysis of Other Provisions

- TAB J: Other Provisions
- TAB K: Budget Impact

PART III: Recommendations of Advisors

- TAB L: Recommendation of Advisors
- TAB M: Detailed Comments of Advisors

I recommend that you review the attached analysis and meet with your advisors to discuss the bill and their views.

It should be noted that the current act expired Monday, December 15. If the bill is vetoed, controls will have expired as of that date.

TAB A

DESCRIPTION OF THE PRICING PROVISION

The pricing provision in the Energy Policy and Conservation Act is an amendment to the Emergency Petroleum Allocation Act that mandates the following changes:

- o The existing price control scheme (i.e. old oil at \$5.25 per barrel and new oil uncontrolled) is replaced with a "domestic composite" control methodology. All domestic oil is initially controlled at an average price of \$7.66 which can be increased as follows:

  - The composite may be increased monthly at the discretion of the President by an amount equal to the GNP deflator, but not greater than 7% per year, throughout the life of the program. An additional three percentage points may also be added at the discretion of the President through February, 1977 to provide a production incentive, but the total upward adjustment (GNP plus production incentive) cannot exceed 10 per cent per year unless authorized by Congress.

  - On February 15, 1977, the President submits his recommendations regarding both the appropriate size of the production incentive escalator for the remainder of the program and the new ceiling limitation on the total inflator. The recommendation becomes law if not disapproved by either House of Congress. If disapproved, the President may submit another recommendation.

  - Increases over and above the initial 10% limitation may be made at any time during the 40 month life of the program upon a Presidential recommendation that is not disapproved by either House. These recommendations can be submitted every 90 days and are maintained for the life of the program if approved.

  - Alaskan oil can be excluded from the composite price calculation upon a recommendation of the President that is not disapproved by either House. This exclusion, the effect of which is to raise the average price for all domestic oil, cannot occur until April 15, 1977 (approximately six months before Alaskan oil will begin to flow through the pipeline).

- o The President is provided flexibility to set various prices for different categories of oil or fields in order to stimulate production provided the composite level is not exceeded.

- o The mandatory control program converts automatically to standby at the end of 40 months. It can only be maintained in full mandatory status by the President based upon certain findings. Congress cannot prevent the conversion to standby except, of course, by passing a new law. Consistent with our IEA obligations, the standby authorities expire 30 months after the 40 month conversion to standby controls.

- o The President is authorized to propose dismantling as much of FEA's regulatory program as possible (primarily price and allocation controls on wholesalers and retailers which are the bulk of those currently controlled by FEA). Each such deregulation action, if not disapproved by a one House veto is permanent. Under current law, each such change requires renewal every 90 days. The objective here, which is underscored in the Conference Manager's Report, is to reduce FEA's regulatory program to a crude price control system as soon as possible, coupled with entitlements to insure the competitive viability of refiners who do not have access to low priced oil.

SUMMARY

By way of summary, the pricing provision provides for:

- One automatic (statutory) mechanism for increasing prices throughout the 40-month program consistent with the GNP deflator up to a limit of 7% per year;

- Automatic increases of an additional 3% above the GNP deflator for the first year as a production incentive; and

- Other price increases at any time if proposed by the President and not disapproved by either House.

TAB B

COMPARATIVE PRICE SCENARIOS

I. General Information

The price provision initially controls all domestic crude oil at an average price of $7.66. If one assumes that the recent OPEC price increase has been fully rolled-through in domestic prices (which is not the case), the current average price of domestic oil is approximately $8.75. If the calculation is made without the $2.00 import fee in place, the current price of domestically produced crude oil would be approximately $7.95. Since the recent OPEC price increase has not been reflected in domestic prices, the current price of domestically produced crude oil without the fee is estimated to be equal to or slightly less than the $7.66 established in the bill.

In evaluating the price effects of this program, comparisons with the existing controls program or the 39 month program are heavily influenced by the status of the import fee and the assumptions made about the rate of escalation that will be allowed by the Congress. Given current legal uncertainties with the fee, it has been removed for comparative purposes.

The pricing provision is evaluated and compared to other programs (e.g., immediate decontrol, the 39 month proposal) according to three alternatives that reflect different Congressional outcomes in response to future Presidential recommendations:

- Unfavorable Congressional action, i.e., with the 3% escalation disapproved after February 1977 and no exemption of Alaska from calculation of the composite price.

- Moderate Congressional action, i.e., with the 10% escalation through the 40 months and Alaska exempted.

- Favorable Congressional action, i.e., a 12% administrative rate approved by Congress during the first year, a 15% rate approved for the second and successive years, and Alaskan oil exempted.

II. Comparative Price Impacts of Alternative Scenarios

	Average Domestic Price ($/Bbl.)				
	1/76	1 Yr.	2 Yr.	3 Yr.	40 Mos.1/
Current Controls	7.95	9.11	9.84	11.02	11.14
39 Month Program	7.95	8.96	10.74	12.97	13.45
Immediate Decontrol	12.00	13.90	14.65	15.37	15.58
Conference Bill					
Unfavorable	7.66	8.43	9.02	9.65	9.88
Moderate	7.66	8.43	9.27	11.03	11.42
Favorable	7.66	8.58	9.87	12.01	12.52
Est. World Price2/	13.00	14.40	15.15	15.87	16.08

1/ 39th month shown as 40th for comparative purposes.

2/ Assumes that actual OPEC prices increase at about 5% per year after June 1, 1976.

III. Range of Opportunities for Decontrol of "Old" Oil

Differing amounts of "old" oil can be controlled depending upon the assumptions that are made regarding future Congressional action and the maximum price that is to be allowed for any domestic oil. The following examples illustrate the range of opportunities according to alternative Congressional actions.

- If "old" oil is held at $5.25 and "new" oil is allowed to float with or close to OPEC prices, then at the end of 40 months:
  - 28% of the old oil can be decontrolled with "favorable" Congressional action;
  - 2% of the old oil can be decontrolled with "moderate" Congressional action; and
  - None of the old oil can be decontrolled with "unfavorable" Congressional action, and some portion of the new oil would have to be rolled back.
- For purposes of illustration, if one sets the decontrol of 80% of "old oil" as a policy objective, the following prices of "new oil" result at the end of 40 months:

- $13.65 with "favorable" Congressional action;
- $12.00 with the "moderate" assumptions; and
- $10.30 with "unfavorable" Congressional action.

IV. Price Per Gallon Impacts of Alternative Price Scenarios

	Change in Price Per Gallon(¢) 1/				
	1/76	1 Yr.	2 Yr.	3 Yr.	40 Mos.
Current Controls	(1.7)	(.2)	1.5	5.0	5.4
39-Month Programs	(2.5)	(.3)	2.9	7.0	7.8
Immediate Decontrol	5.0-6.0	6.2	8.0	9.7	10.2
Conference Bill					
Unfavorable	(2.8)	(1.7)	(.3)	3.5	4.1
Moderate	(2.8)	(1.5)	.3	4.8	5.5
Favorable	(2.8)	(1.0)	.6	5.9	6.7

1/ All estimates assume full pass through of dealer margins and are compared to the current price. Figures in parentheses represent decreases, but it is unlikely that price reductions will flow through completely to the "pump". Further, the price changes here are related solely to product price changes and do not include any other factors such as increased rents, labor costs, and so forth. The rollback associated with current controls reflects the removal of the $2.00 tariff.

TAB C

ENERGY IMPACTS OF ALTERNATIVE PRICE SCENARIOS

I. General Information

Your January 15 State of the Union proposals set goals to reduce imports by 1 and 2 million barrels per day for 1975 and 1976 respectively. Even if these programs were implemented now, their effects would be delayed a year, i.e., 1976 and 1977 because of the time that has elapsed as we attempted to reach agreement with the Congress.

Shown below are the expected energy impacts under each of the pricing alternatives described in Tab B, excluding other elements of your program.

II. Energy Impacts of Alternative Price Scenarios

	Domestic Production (Thousands Bbl/day)[1/]		
	After 1 Year	After 2 Years	After 3 Years
Current Controls	10,120	10,120	11,220
39 Month Program	10,220	10,420	11,620
Immediate Decontrol	10,220	10,420	11,720
Conference Bill			
Unfavorable	10,070	10,120	11,220
Moderate	10,070	10,170	11,520
Favorable	10,070	10,170	11,620

	Consumption (Thousands bbl/day)		
	After 1 Year	After 2 Years	After 3 Years
Current Controls	18,512	19,547	20,467
39 Month Program	18,517	19,495	20,368
Immediate Decontrol	18,279	19,225	20,144
Conference Bill			
Unfavorable	18,604	19,679	20,637
Moderate	18,604	19,658	20,550
Favorable	18,597	19,649	20,410

[1/] The basis of calculation used to derive these estimates is consistent with the approach used all year. However, some analysts argue that the short-term production effects are more significant.

	Imports (Thousands Bbl/day)[1]					
	After 1 Year		After 2 Years		After 3 Years	
Current Controls	7,992		9,027		8,847	
39 Month Program	7,897	(- 95)	8,675	(-352)	8,348	(-499)
Immediate Decontrol	7,659	(-333)	8,405	(-622)	8,024	(-823)
Conference Bill						
Unfavorable	8,134	(+142)	9,159	(+132)	9,007	(+160)
Moderate	8,134	(+142)	9,088	(+ 61)	8,630	(-217)
Favorable	8,127	(+135)	9,079	(+ 52)	8,436	(-411)

The production effects of the scenarios portrayed for the Conference Bill are remarkably similar, primarily because of the lead times involved in drilling responses to price changes. Production activities at the end of the second year, for example, would largely reflect efforts begun in the first year and would not be significantly affected by minor price changes during the second year. Similarly, decontrol only results in an additional 150,000 barrels per day over the Conference Bill at the end of the first year. This reflects the fact that production in the first year (1976) will primarily be the result of activities initiated in 1975. The greater production effects in the third year of the "moderate" or "favorable" cases as compared to the "unfavorable" case indicates the significance of future Congressional action regarding Alaska.

The consumption effects of the various Conference Bill scenarios and alternatives show greater variation than the production effects. This is due to the fact that prices for domestic oil determine production whereas consumption is influenced by an average of both domestic oil and imported oil -- a higher average price than that provided domestic producers.

If the other short-term measures you requested as well as the current pricing provision are enacted, the following net import savings would result compared to a continuation of current controls and a removal of the fee.

	Import Saving (Thousands Bbl/day)		
	After 1 Year	After 2 Years	After 3 Years
39 Month Program	625	1,112	1,309
Immediate Decontrol	863	1,382	1,633
Conference Bill			
Unfavorable	388	628	650
Moderate	388	699	1,027
Favorable	395	708	1,221

[1] Figures in parentheses indicate import savings attributable solely to price effects.

In summary, the current pricing provision alone results in increased imports during the first two years and substantial savings by the third year when compared with a continuation of current controls. By the third year the import savings attributable solely to the pricing provision are roughly equal to the 39 month plan, but only one-half of those that would occur with immediate decontrol. If the pricing provision of the bill is combined with your other proposed short-term actions, substantially less savings result than under your original goals, but it is still a positive program to reduce imports.

The long-term supply, demand and import effects depend upon what happens after 40 months. If price controls end, then by 1985 the full positive effects of decontrol will be felt. If controls continue, the import-vulnerability costs of short-term controls will be magnified. The effect of continued controls, however, would be dependent on the form of controls ultimately extended. If, for example, a composite price were set which merely escalates at the rate of the GNP deflator, imports could be 5-7 million barrels per day higher by 1985.

Tab D - Economic Impact of Immediate Decontrol

In the event of immediate decontrol we estimate that the average price of petroleum products will rise by roughly 5 to 6 cents per gallon. It is likely that 2 to 3 cents of the rise will occur by January, and that the price increase will be fully in place by April, 1976. This pattern of prices suggests that the Consumer Price Index by the end of 1976 is likely to be 1.0 to 1.2 percent higher than it would otherwise have been.

As a consequence of the increase in prices there would tend to be a small decline in real GNP which would be equivalent to about 0.2 higher unemployment rate by the end of 1976. This is without offsetting fiscal or monetary policy initiatives. (The effects on unemployment will not peak until 1977.) However, we estimate that with the windfall profits tax, rebates to consumers and appropriate monetary policy adjustments the effect on unemployment is likely to be largely offset. It is our judgment, however, that the ability to obtain an acceptable windfall tax program and an accompanying rebate mechanism is very small.

TAB E

ABILITY OF PRICING PROVISION TO LEAD TO DECONTROL

The pricing provision contained in the Energy Policy and Conservation Act converts automatically to standby at the end of 40 months and can only be maintained in full mandatory status beyond that time by the President on the basis of certain findings. Congress cannot prevent the conversion to standby except, of course, by passing a new law.

The extent of the pressure on the President to maintain the program at the end of 40 months will be a function of the prevailing "gap" between composite domestic prices and world prices. This in turn will be a function of:

- The prices charged at the time by the members of OPEC; and

- Our success in achieving increased inflators in the composite price through our 90 day actions.

The difference between current domestic prices and what the uncontrolled price would be if the import fee were removed is slightly above $4.00 per barrel. If OPEC continues to increase its price with inflation and we fail in our attempts to increase the inflator (e.g., follow the unfavorable scenario above), the gap will be almost $6.00 after 40 months and the President will be under considerable pressure to maintain the program at the end of 40 months (see Table below).

If, on the other hand, OPEC is unable to increase its price to fully keep pace with inflation or we are successful in our efforts to increase the inflator (e.g., the moderate or favorable scenarios above), the gap will be small and the pressures on the President to maintain the program will be reduced significantly or eliminated. Under moderate assumptions about the Conference bill, the price differential would range from $1.93-$4.19 per barrel, depending upon future OPEC price increases; under favorable conditions, the range would be $0.80-$3.06 per barrel.

The attached charts depict illustrative ranges between each of the pricing scenarios and OPEC at the end of 40 months.

- Chart 1 indicates ranges between the "national average price" of crude oil (domestic plus foreign crude) and OPEC. Chart 2 translates the gap into per gallon prices that the refiner or consumer would face if controls expire at the end of 40 months.

- Chart 3 indicates the gap between the price paid to domestic producers and the OPEC price at the end of 40 months. Although the gap faced by consumers is significantly smaller (Chart 1) than the gap in the prices paid to domestic producers, the figures in Chart 2 are provided to indicate the "jump" in dollar per barrel revenues that producers would receive if controls lapse. This is relevant to the extent that the Congress of 1979 feels as strongly about oil industry profits as does the current Congress.

CHART I

Differences Between Composite Crude Oil Price (Regulated) and Free Market Composite Price* After 40 Months

Current Impact of Immediate Decontrol $3.30

	Constant Nominal OPEC Price ($13.82/bbl)		Constant Real OPEC Price ($16.75/bbl)		Real OPEC Price Rising 3% ($18.10/bbl)	
	Composite Crude Oil Price ($/bbl)	Difference ($/bbl)	Composite Crude Oil Price ($/bbl)	Difference ($/bbl)	Composite Crude Oil Price ($/bbl)	Difference ($/bbl)
Conference Bill						
Unfavorable	$11.63	$1.89	$12.94	$3.51	$13.54	$4.26
Moderate-unfavorable	11.86	1.66	13.10	3.35	13.67	4.13
Moderate-favorable	12.42	1.10	13.66	2.79	14.23	3.57
Favorable	13.33	.19	14.56	1.89	15.13	2.67

*The free market composite price was calculated using a domestic price equal to the OPEC price less $.50, using "immediate decontrol" weights. This price equals $13.52, $16.45, and $17.80 for the constant nominal price, constant real price, and 3% rise in real price assumptions, respectively.

CHART II

CONSUMER PRICE IMPACT UPON TERMINATION OF CONTENTS AFTER 40 MONTHS 6¢/GALLON NOW

	IF FURTHER OPEC PRICE INCREASES (CENTS/GALLON)	IF NO FURTHER OPEC PRICE INCREASES (CENTS/GALLON)
Current Controls	5.8	2.8
39 Month Program	2.9	-0-
Immediate Decontrol	--	--
Conference Bill:		
Unfavorable	7.4	4.5
Moderate	5.6	2.5
Favorable	4.1	1.1

These calculations assume no increase in demand as a result of lower OPEC Prices and thus probably overstate the effect of removing controls.

CHART III

DIFFERENCES IN DOMESTIC COMPOSITE AND
DOMESTIC OIL PRICES UPON TERMINATION OF CONTROLS

	IF FURTHER OPEC PRICE INCREASES			IF NO FURTHER PRICE INCREASES		
	Domestic Composite Price ($/BBL.)	Domestic Prices Upon Termination of Controls	Difference ($/BBL.)	Domestic Composite Price ($/BBL.)	Domestic Prices Upon Termination of Controls	Difference ($/BBL.)
Current Controls	11.14	15.58	4.44	9.85	13.32	3.47
39 Month Program	13.45	15.58	2.13	13.32	13.32	--
Immediate Decontrol	15.58	15.58	--	13.32	13.32	--
Conference Bill:						
Unfavorable	9.88	15.58	5.70	9.88	13.32	3.44
Moderate	11.39	15.58	4.19	11.39	13.32	1.93
Favorable	12.52	15.58	3.06	12.52	13.32	0.80

TAB F

ALTERNATIVES IF S. 622 IS VETOED

Controls on oil prices expired at midnight, Monday, December 15. If you decide to veto the Energy Policy and Conservation Act (S. 622), decontrol will occur and a number of previously identified problems will result over a relatively short period of time -- probably before Congress comes back into session in January. These problems include:

- 6¢ per gallon price increases after the import fee is removed
- Propane price and supply problems
- Independent refiner and service station impacts
- Windfall profits in the petroleum industry
- Problems for farmers, fishermen, airlines, petrochemical companies, asphalt contractors and other special impact groups.

Since it is likely that Congress will let these problems develop for some period of time for political reasons, it may be appropriate to couple any veto of S. 622 with one or more legislative recommendations as a way of shifting part of the liabilities of immediate decontrol to the Congress. Such proposals would also assist efforts to sustain a veto.

There are basically four options if you decide to veto S. 622 and agree that we should follow the veto with alternative legislative proposals. These options and an evaluation of each option is provided below.

OPTION 1: Propose a limited number of changes to the bill which would permit Presidential acceptance, including higher guaranteed escalators, automatic removal of Alaska from the composite, and the elimination of both the coal loan guarantee program and the GAO audit provisions.

Pros:

- If accepted, would improve pricing provision while insuring that other desirable provisions in bill are enacted.

Cons:

- It is unlikely that Congress would make any of the desired changes, particularly in the pricing section; in fact, the pricing provision could be made even more restrictive.

- Even if changes are possible, it is unlikely that industry or producing state delegations would support the overall bill with any of the modifications that would be accepted by this Congress.

OPTION 2: Go for immediate decontrol and repropose the initiatives we submitted in August to mitigate the effects of decontrol, including a windfall profits tax, propane allocation, and price control authorities, subsidies for independent refiners, and tax rebates for farmers and fishermen.

Pros:

- Optimum program for energy self-sufficiency and deregulation of the industry.

- Best posture if complete decontrol is near-term objective.

Cons:

- Congress is not likely to approve the major components of the legislative initiative, particularly windfall profits tax and price controls on propane -- at least until problems have begun to occur.

- Major price increases will result almost immediately.

- Economic recovery could be effected.

OPTION 3: <u>Propose a phased decontrol plan (i.e., 39 month) and continuation of allocation act.</u>

<u>Pros</u>:

- If accepted, would result in gradual decontrol, but at a more certain rate than S. 622.

- No major one-time price increase would occur.

- Congress is familiar with program.

<u>Cons</u>:

- Would likely be rejected; House rejected plan once before and Conferees were strongly opposed to the structure of the program.

- Given Congressional work on this issue, resubmittal of 39 month plan could result in considerable acrimony and hostility.

OPTION 4: <u>Propose simple extension of allocation act through the election</u>:

<u>Pros</u>:

- Industry prefers current controls, at least the producing component of industry; most would like to avoid the consequences of decontrol, however.

- Simple extension would probably be easiest to achieve in near term.

<u>Cons</u>:

- Congress will delay a simple extension until problems develop, and will probably amend with a cap on new oil and allow no escalators as in current bill.

- With exception of initial price of new oil, S. 622 is a better bill in that it does provide for escalation in prices and the dismantling of

FEA's regulatory apparatus on wholesalers and retailers (with the exception of crude producers, the industry is clearly better off with S. 622 than with current controls).

- Would put us back to January 1975; no progress would have been made.
- Oil prices would be a major issue of the campaign.

SUMMARY AND RECOMMENDATIONS

It is clear that all of the options have their drawbacks, primarily because of the difficulty we will have in getting Congress to approve any of the alternatives without major changes if they agree to act at all. Consequently, each of the alternatives should be evaluated largely in terms of the political posture they would allow us to adopt during the next four to eight months.

If you decide to veto S. 622, I would recommend Option 2 -- go for immediate decontrol and resubmit initiatives we submitted in August to mitigate effects of decontrol.

TAB G

GENERAL CONCLUSIONS

Apart from the specific impacts of the price provision contained in the Energy Policy and Conservation Act, several major conclusions of a general nature can be drawn about the provision:

- The provision does not achieve the results of your 39-month proposal.

- In price terms, the provision is worse than current controls if one assumes the unfavorable case, roughly equal to current controls if one assumes the moderate case, and better than current controls if one assumes the favorable case.

- The provision will have the effect of reducing production from domestic sources by up to 250,000 barrels per day after two years, compared to the level from instant decontrol. It gives up using the even higher prices we have sought to assure conservation, and thereby increases demands by 430,000 barrels per day.

- Most of the loss in production will be from stripper wells (less than 10 barrels/day). The FEA believes that pricing provision will allow, however, an upper tier high enough to provide adequate incentive to producers to explore, develop and produce new fields such as the OCS and Alaska.

- The provision reduces domestic oil industry revenues in the short-term by $600 million from 1975 rates, even though this is largely due to the removal of the tariff.

- If the bill is enacted, new regulatory decisions of a different kind will be required to determine the prices to be allowed for crudes of different origins and a product entitlements program will be required.

- Apart from price, the program is better than current controls in that it allows and the Conference Manager's Report encourages FEA to dismantle its regulatory controls (price and allocation) on most of the industry (e.g., wholesalers, retailers, etc.).

- The provision is the best that could be achieved from this Conference Committee and probably this Congress (e.g., the Conferees started with a domestic composite price of $5.50 and no escalator and eventually stretched to the limit allowed within the scope of the Conference Bill). The Congress will not agree to a higher price or shorter period, even with a veto.

- The program is opposed by many in the oil industry and some in the Congress, particularly members from both parties who come from the producing states. They would prefer either a continuation of current controls or immediate decontrol.

- Some people believe that we can be more successful than even the "favorable" case in our attempts to increase the escalator.

TAB H

REASONS TO REJECT THE PRICING PROVISION

Major reasons for rejecting the pricing provision contained in the Energy Policy and Conservation Act include the following:

- o The pricing provision falls short of your initial goals and your 39-month program. The Nation's ability to reduce its imports will be constrained, even though the program will move in that direction over time.

- o There are other provisions in the bill that are undesirable, particularly the coal loan guarantee program, the GAO audit provisions, discretionary authority to set appliance standards, and an unduly high target in 1985 for autos. (See Tab J.)

- o The regulatory decisions required to implement the program will impose a heavy burden of responsibility on the FEA Administrator in determining how to price various categories of old oil.

- o If decontrol is sustained, both initially and over the long-term, rejection of the bill would end a complex regulatory program and preclude a possible "evolution" of the program into other, more pernicious regulatory involvements by the Federal government. Rejection is also consistent with the thrust for regulatory reform.

- o If the bill is accepted and we are not successful in escalating the price towards the world price over time, there is the risk that the program would not end after 40 months -- that controls would be continued indefinitely.

- o The need for the President to take action to increase the composite price -- both with and without Congressional approval -- will put the political burden of any necessary price increases on the President.

- o Some will view acceptance of the bill as a reversal of several of the basic principles of the Administration, even though Congress would move no further.

- o A continuation of controls will lead to long-term resource misallocations and corresponding effects on growth.

- Prior to February, 1977, producers will be uncertain regarding allowed crude oil prices after February, 1977. The unknown variable will center around whether Congress will allow an escalator higher than the $7.66 plus the GNP deflator.

TAB I

REASONS TO ACCEPT CONFERENCE BILL

The major reasons for accepting the pricing provision contained in the Energy Policy and Conservation Act include:

- The provision is the best that could be achieved from the Conference and probably the best from this Congress.
- Uncertainty over the government's oil pricing policy will be eliminated, even though there will be uncertainty regarding specific crude prices after February, 1977 at levels over the $7.66 plus the automatic GNP deflator.
- Continuing debate over a windfall profits tax will be eliminated and pressures for divestiture will be cooled substantially.
- Although not everything we have asked for, we still have the ability to keep the presssure on for higher prices every 90 days.
- As outlined later, the bill contains many components of your original energy program.
- Acceptance of the provision will remove the pricing issue and, to a great extent, the petroleum industry from the election debate next year.
- If vetoed, complete decontrol might not last long and there would be repeated attempts at legislating a rollback either separately or as an amendment to numerous other related bills. Future measures could be less desirable than the current provision. The other parts of your energy program contained in the bill might not be achieved until after the election.
- Part of the public will perceive acceptance as an agreement on energy policy between the Executive and Legislative branches, something an increasing number of people are calling for. This agreement and progress would be viewed by many as having been brought about by your efforts and pressure on the Congress.
- Acceptance will strengthen the recovery and lead in the short-run to higher output and lower unemployment.

12/18/75

NON-PRICING PROVISIONS OF H.R. 7014

I. Key Administration Provisions in H.R. 7014

- Strategic Reserves

While the provisions are quite similar in concept to the Administration's program in a number of ways, there are important differences. These include:

1) a mandatory requirement for early storage of 150 million bbls in 3 years, which will be difficult to achieve and may necessitate requiring industry to store part of the 150 million bbls.

2) a 7-year target to store at least 400 mil. bbls; the longer term program's implementation is contingent on FEA transmitting a plan to Congress subject to either House disapproval (as is each major change thereto).

3) no provisions for NPR proceeds to finance the program, although this could be rectified by the NPR bill now in conference.

The mandatory nature of the program will commit us to large Federal outlays, further adding to uncontrollable category of Federal outlays. The Naval Petroleum Reserves legislation will not be able to generate sufficient funds to finance the early years of the program, even if such authorization is approved. This will further hamper efforts to balance the Federal budget in the FY 1978 period.

- Standby Emergency Authorities

Provides most of the standby energy authorities requested by the President. However, requires approval of a specific conservation and rationing plan by both Houses before either authority could be implemented in an emergency. Further, before rationing can be used, a second Congressional approval is required. Although this can be viewed as an unwarranted intrusion on Executive authority, it is offset to some extent by the fact that such actions will be so pervasive and controversial (e.g., Sunday closing of gasoline stations) that the President could want Congressional concurrence.

- International Authorities

Contains the authorities requested by the President to allow the United States to participate fully in the International Energy Program.

- Coal Conversion

Language extending coal conversion authority is virtually identical to that requested by the President.

- Appliance Labelling

The labelling provisions of this section are similar to the President's program, but involve more complex procedural requirements than the Administration's proposal.

II. Key Provisions of H.R. 7014 Counter to or Inconsistent with the Administration's Program

- Appliance Efficiency Standards

In contrast to the Administration's voluntary program, in this bill the FEA Administrator is required to prescribe energy efficiency targets for thirteen types of appliances, and has discretionary authority to prescribe targets for any type of consumer product whose energy use exceeds 100 kilowatt hours per year. If these targets are not being met, FEA is required to commence standard setting procedures, and has discretionary authority to establish a mandatory efficiency standard for each product which does not comply with the target.

The bill authorizes citizen suits which would allow for suits against the government for nondiscretionary acts associated with this program and against manufacturers, suppliers, and importers for violations.

- Industrial Energy Conservation Reporting

The bill requires the FEA Administrator to set energy efficiency targets for the 10 industries which consume the most energy. Within each of these industries, the FEA shall identify the 50 companies (about 400 total, because of certain exclusions) that use the most energy. The Chief Executive Officer of each company is required to report annually to FEA or a trade association his company's progress in energy conservation. The provision makes mandatory the voluntary program, involving 2,000 companies, now being carried out jointly by FEA and Commerce.

The Administration has consistently opposed mandatory industrial conservation programs and has instead relied on existing voluntary programs.

- State Financial Assistance

The bill provides authorization for a 3-year discretionary State categorical grant program ($50 million for each year) to assist participating States in developing and implementing energy conservation plans and programs.

To be eligible for such assistance, each State plan would be required to include:

° mandatory lighting standards for buildings open to the public (publicly and privately owned)

° "right turn on red laws"

° measures to encourage vanpooling and mass transit

° revisions to State procurement standards.

FEA would have broad discretion over the level of funding provided to States who choose to participate in the program.

- Mandatory Auto Efficiency Standards

The bill sets mandatory fuel economy standards which are consistent through 1980 with those of the Administration's voluntary program. However, the mandatory approach is contrary to the Administration's voluntary program and the bill includes mandatory standards through 1985 and beyond, unlike the Administration's program. The standards that are set may not be attainable under the emission standards emerging from Congress, although there are cumbersome provisions to adjust the fuel economy standards in the 1978-80 period. The standards imposed for 1985 (27.5 mpg) are excessively stringent and any change below 26 mpg is subject to Congressional veto.

- Federal Energy Conservation

The bill requires the President to:

° establish mandatory standards for the procurement decisions made by all Federal agencies

° establish a public energy information program

° establish a 10-year plan for mandatory energy conservation in Federal buildings.

- Energy Impact Statements

The bill requires 5 regulatory agencies to prepare energy impact statements for major actions, as determined by the agency, which might further encumber the regulatory process.

- Coal Loan Program

Bill authorizes $750 million in loan guarantees to new small mines, which if effective at all, will simply subsidize operations of mines. The eligibility criteria for loan guarantee are similar to those in EIA.

- GAO Audits

The bill authorizes the Comptroller General to conduct verification audits on its own or at the request of any Congressional Committee with respect to the books and records of persons who are required to submit energy information or data to FEA, FPC and the Department of the Interior or of all integrated oil companies. The GAO already has this authority when directed by a Congressional Committee, although not by individual Members.

- Prohibition of Joint Ventures

Joint ventures between major oil companies for exploration (but not development) are prohibited on Federal lands, similar to current Interior regulations. The Secretary of the Interior can waive the prohibition in high risk or costly areas, such as the frontier areas of the OCS.

III. Additional Provisions not Contained in the Administration's Program

- Federal Automotive Purchase

A fleet average floor is placed on miles per gallon for future Federal automotive purchases consistent with the mandatory fuel economy standards elsewhere in the bill.

- Automotive Retrofit Devices

An FTC and EPA program for testing automotive retrofit devices and fuel additives is established.

- Energy and Energy Equipment Exports

Authorizes the President to restrict exports of coal, oil, and natural gas, and any materials or equipment necessary for energy production or transportation.

- Materials Allocation

Permits allocation, without a national defense purpose, of materials under the Defense Production Act needed for energy production, transportation or conservation until December 31, 1984.

- MER Regulation

Requires Federal determination to the maximum extent practicable of maximum efficient rates of production for all fields on Federal lands. Authorizes the President to require production at this rate at any time. This represents a Federal invasion of a traditional State function.

- Asphalt Allocations

Brings asphalt into the allocation program for the first time.

IV. Non-Pricing Changes to Allocation Program

- Allocation of Increased Crude Prices

No more than a proportionate passthrough of increased crude oil costs are permitted for No. 2 oils (home heating oil and diesel), aviation fuel, or propane, with provision for Presidential changes. This writes into law current regulations on propane and No. 2 fuels, and adds a limitation for aviation fuels.

- Treatment of Banked Costs

Imposes new limits on the time in which refiners must pass through permissible cost increases.

- Penalties for Violation of Allocation and Price Rules

Increases the penalties for violation of the FEA allocation and pricing rules.

- Small Refinery Entitlements

Exempts small refiners from purchase of entitlements giving them a $33 million monthly subsidy at the expense of consumers and competitors. The scope of the exemption could be limited by a proposal by the President, which would be subject to an either-House Congressional veto.

The legislation does provide for the President's proposing, subject to either House veto, a way to make allocation and downstream price controls standby which if accepted, would eliminate a complex and unwarranted regulatory program. The bill removes the provision in the existing Allocation Act which requires resubmittal of decontrol actions to the Congress every 90 days.

TAB K

ESTIMATED BUDGETARY IMPACTS OF OMNIBUS BILL

1. Compared to immediate decontrol, the omnibus bill has a substantial adverse impact of $5.5 billion in FY 1976 and $8.2 billion in FY 1977 due to [redacted] factors, as indicated by the following:

   - Higher taxes paid by oil producers ($6.7 billion), although partially offset by higher outlays for Federal fuel purchases ($.5 billion).

   - The fact that the omnibus bill requires an accelerated early strategic storage program of 150 million barrels within three years resulting in significantly higher costs in FY 1976 than might have been contemplated under the President's bill.

   - Outlays for regulatory/quasi-regulatory programs required by the omnibus bill.

Budget Impact of Omnibus Bill vs. Decontrol

	(Billions $) FY 1976	FY 1977
Omnibus Bill		
Receipts lost[1]	-0.9	-1.3
Increased outlays	-0.4	-1.1
	-1.3	-2.4
Decontrol (no windfall profits)		
Receipts gained	+4.7	+6.7
Increased outlays (incls. adj. for increased fuel costs & outlays due to increase in CPI)	-0.5	-0.9
	+4.2	+5.8
Fiscal advantage, decontrol over omnibus bill	+5.5	+8.2

2. Compared to current controls, the omnibus bill will have an adverse impact on the budget of $1.3 billion in FY 1976 and $2.5 billion in FY 1977. The sources of this impact are two-fold:

---

[1] Includes lost receipts of $30 million in FY 1976 and $90 million in FY 1977 because of lower prices received for NPR production. Passage of NPR legislation is assumed.

(a) Reduced Treasury receipts resulting from:

- Lower corporate taxes paid by producers of new oil whose prices are being rolled back from approximately $12.50 to $11.30/barrel, or about $650 million in FY 1977.

- Lower revenues from Federal leasing activities and Elk Hills production (about $690 million) as a result of lower new domestic crude prices under the omnibus bill.

(b) Budget outlays for programs included in omnibus bill, including Federal grants to States for conservation programs, strategic storage, administrative costs of the appliance labelling and auto efficiency program, loan guarantees, etc., amounting to about $1.12 billion in FY 1977.

3. Compared to <u>current</u> controls, <u>immediate</u> decontrol would have a net <u>positive</u> effect on the budget. Although outlays will increase by approximately $500 million in 1976 and $900 million in 1977 as a result of higher fuel prices, these increases will be more than offset by the approximate increase of $6.7 billion in higher corporate taxes paid by oil producers. If the Administration's windfall profits tax were to be enacted, Federal revenues would increase by about $11 billion in FY 1977.

<u>Outlay Impact of Omnibus Bill</u>

Estimates of the outlay impacts of the omnibus bill are based on an analysis of the provisions of the bill and the programs that are mandated by it. The estimates are based on likely expenditures. Of particular importance are:

- The number of States that participate in the voluntary conservation categorical grant programs which are funded by FEA.

- Whether the Administration requires industry by regulation to store a portion of the petroleum required as part of the early strategic storage system.

- The amount of Federal Government administrative costs for such programs as mandatory fuel economy, continued petroleum allocation and enforcement, appliance labelling, industrial conservation reporting, etc. Estimates below are based on recent experiences.

The table that follows indicates the estimated outlays for FY 1976 and FY 1977. Each of the programs would continue beyond FY 1977.

	(Millions $) FY 1976	FY 1977
1. Grants to States for conservation programs	0	50
2. Strategic storage[1/]	300	930
3. Administrative costs	30	125
Total	360	1,105
4. Loan guarantees to new small coal mine developments (Auth. $750M)	Could have impact of $125M on Federal debt ceiling.	

[1/] Outlays shown are those in excess of the President's program. Outlays may be reduced to the extent importers and refiners are required, through a new regulatory program, to store additional quantities of petroleum products.

TAB L

RECOMMENDATIONS OF ADVISORS

The detailed views of your advisors are contained in Tab III. By way of summary, all agree that the only alternatives are the Conference Bill or immediate decontrol - that Congress will not do better on the pricing issue than the Conference Bill. They also agree that a veto will lead to considerable campaign rhetoric next year and attempts to pass reactive, punitive legislation.

They are not in agreement regarding whether or not the bill should be signed. Those marked with an asterisk have submitted statements regarding their views and concerns, and these are included in Tab III.

o <u>Advisors favoring signing</u>

(1) Morton*
(2) Zarb
(3) Seidman*
(4) Cannon*
(5) Train
(6) Seamans
(7) Friedersdorf
(8) Scowcroft
(9) Dunlop

o <u>Advisors favoring a veto</u>

(1) Simon*
(2) Greenspan*
(3) Kleppe
(4) Coleman (if immediate decontrol can be avoided)

o <u>Advisors whose views are not included</u>

(1) Kissinger has already given his views to the President

THE WHITE HOUSE

WASHINGTON

December 8, 1975

MEMORANDUM FOR: FRANK ZARB

FROM: JIM CANNON

SUBJECT: Energy Bill

On its merits, the legislation seems right on the margin of whether it is good enough to sign, or so bad it has to be vetoed.

From the standpoint of the President's policy decision to reduce the Federal government, the bill is bad because it would increase Federal intervention.

However, I believe there is a larger question throughout the country: "Will Washington ever get together on an energy program?"

At Domestic Council hearings in five cities, we have heard repeatedly that the President and the Congress ought to agree on some kind of a plan to end the uncertainty about energy.

Consequently, I recommend that the President sign this imperfect bill with a candid message pointing out the good and the bad in the bill, and stating that amendments will be sent to Congress to correct these faults.

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

December 8, 1975

MEMORANDUM FOR THE PRESIDENT

Subject: The Energy Policy and Conservation Act of 1975

I strongly recommend that you veto the Energy Policy and Conservation Act of 1975, and take action to bring about immediate decontrol of oil prices as the best way to achieve your basic energy policy objectives.

Basic Options -- It appears that you have only two viable options -- (1) to sign the Conference Bill or (2) to veto the bill and permit immediate decontrol of oil prices. From all indications, Congress will not give you a better energy bill and will probably not extend the present controls for any substantial period of time.

While there is admittedly some risk that Congress will react to a veto of the bill by passing even more undesirable energy legislation, this is a risk which, in my opinion, you must take. Furthermore, I have discussed the bill with Senator Russell Long, and he has indicated that he would press for separate legislation enacting the desirable features of the bill. He believes that this can be accomplished.

Criteria for Evaluating the Bill -- In considering whether to sign or veto the proposed bill, there are a number of key factors which I believe need to be carefully considered. They are:

1. The compatibility of the bill with your basic energy objectives.

2. The effects on the economy and economic recovery.

3. The effects on domestic petroleum supply and demand.

4. The effect on imports of oil.

5. The effect of frequent Congressional reviews.

6. The effect of continued government regulation on long-run efficiency of the petroleum industry.

7. The effect on the prospect for the ultimate complete decontrol of oil prices.

8. The effect on our international energy objectives.

9. The effect on our continued vulnerability to the OPEC cartel.

10. The effect on opposition to indexation of OPEC oil prices.

The key to evaluating the effects of the bill are the pricing provisions which roll back the composite price of crude oil to $7.66. These provisions clearly fail to advance the basic conservation, supply expansion, and import reduction objectives that you set earlier this year.

As discussed in more detail below, the bill's provisions, when compared with immediate decontrol, would: (1) increase the U.S. demand for petroleum products while reducing the supply of domestically produced crude oil; (2) result in increased OPEC imports; (3) reverse the Administration's policy of reducing the U.S. vulnerability to the OPEC cartel;

(4) create major investment decision uncertainty in the petroleum industry; (5) give the FEA broader power to allocate revenues among the various segments of the petroleum industry; and (6) continue the already excessive and unnecessary government regulation of the domestic petroleum industry.

Although the bill does contain a number of positive provisions (e.g., authority for strategic reserves, coal conversion, and standby rationing and conservation), there is nothing in these provisions which is so essential to the development of a sound energy policy that it offsets the detrimental effects of the pricing provisions. Your decision as to whether to sign or veto the bill should, in my judgment, be based on a careful analysis of the pricing provisions.

<u>Compatibility with Your Basic Energy Policy Objectives</u> -- The net effect of the bill is clearly incompatible with your basic energy policy objectives even though it contains a number of the components of the Energy Package you proposed earlier this year. In your State of the Union Message last January, you announced the following national energy policy goals:

1. Reduce oil imports by 1 million barrels per day by the end of 1975 and 2 million barrels by the end of 1977, through immediate actions to reduce energy demand and increase domestic supply.

2. Eliminate vulnerability by achieving the capacity for full energy independence by 1985. This means 1985 imports of no more than 3-5 million barrels of oil per day, all of which can be replaced immediately from a strategic storage system and managed with emergency measures.

The Energy Policy and Conservation Act would work in opposition of these goals by increasing our vulnerability to OPEC interruption and price escalation in that the pricing provisions would increase demand, decrease domestic exploration and production and increase imports.

Economy and Economic Recovery -- When compared with immediate decontrol, the pricing section of the bill does provide some short-term macroeconomic benefits which need to be weighed against the harmful effects on supply and greater dependence on OPEC. Immediate decontrol would admittedly decrease real GNP growth and increase unemployment and inflation.

The Treasury Department estimates the following macroeconomic impacts when comparing the present pricing situation to the Conference Bill and immediate decontrol:

MACROECONOMIC IMPACT OF
CHANGING FROM CURRENT CONTROLS

	1976		1977	
	Immediate Decontrol	Bill	Immediate Decontrol	Bill
GNP Growth Rate	-0.4%	+0.8%	-0.6%	+1.0%
Unemployment Rate	+0.1	-0.1	+0.2	-0.3
Inflation Rate				
(a) GNP Deflator	+0.6	-0.7	+0.6	-0.6
(b) CPI	+0.3	-0.6	+0.5	-0.5

Fiscal and monetary policy could, however, substantially reduce the impact of decontrol. Therefore, I believe that on balance the short-run adverse economic effects of immediate decontrol are less of a danger to the nation than the long-term economic and national security risks inherent in the increased imports of petroleum from insecure sources.

<u>Domestic Petroleum Supply and Demand</u> -- The immediate effect of the bill (including elimination of the import fee) is to roll back crude prices from an average of $8.75 per barrel to $7.66. This will cause a loss of producer revenue of $3 billion the first year. When considered along with the recent elimination of percentage depletion, this results in a substantial reduction in cash flow to the industry and in funds available for exploration and development. In addition, the roll back means that, upon expiration of the price controls in the bill, the <u>real</u> price of oil could be <u>lower</u> than it is at present -- especially if Congress uses its power to prevent price increases.

Signing the bill would, therefore, be a clear signal to producers that the investment climate is unfavorable and would encourage them to make investment decisions on the most pessimistic set of prices that could result from the bill. The result will be reduced exploration and development activities, particularly in high-risk areas, and in enhanced recovery. Production will continue to drop and this decline in production will accelerate as the effects of diminished exploration and development are felt. While it is difficult to provide an accurate estimate of the supply benefits of immediate decontrol as compared with the bill, various estimates suggest that they could reach 500,000 barrels per day within 2-3 years.

In addition, there will be a decline in average petroleum product prices as a result of the bill. Depending on one's assumptions, this could range initially from 1.8¢ to 3.3¢ per gallon which would mean that the bill could increase demand by as much as 500,000 barrels per day within 2-3 years when compared with immediate decontrol.

<u>Imports</u> -- Increased demand coupled with declining domestic supply can only result in increased imports from the Mideast. Over the forty month decontrol period, Treasury estimates that the bill would increase imports by at least 1 million barrels

per day above the level that could be expected with immediate decontrol. In addition, some industry estimates show an increase of 3 million barrels per day by 1980 and 5-7 million barrels per day by 1985.

Frequent Congressional Reviews -- The proposed bill provides for Congressional review of Presidential actions concerning prices with disapproval possible upon a majority vote of either house. Actions subject to review include:

1. Establish a separate price ceiling for Alaskan oil,

2. Modification of the ten percent adjustment limitation, and

3. Modification of the three percent incentive adjustment.

The ultimate effect of the Congressional review authority is to create great uncertainty in the mind of the producers that future oil prices will even approach the level which would otherwise be permitted under the bill. If the proposed bill is vetoed and immediate decontrol occurs, that result can only be disapproved by a two-thirds majority in both Houses, while a simple majority in either House can prevent part of the price increases contemplated by the bill.

Continued Government Regulation on Efficiency of the Petroleum Industry -- The present system of price controls, allocations and entitlements has created great distortions in the energy industry. The bill would add a new layer of uncertainty for the oil industry as companies would have no way of knowing (1) how Congress will exercise its restraining role in determining the rate of oil price increase, (2) how FEA will make its determinations as to how to price new and old oil to reach the composite price, or (3) how FEA will exercise its authority to allow exceptions to the pricing rules.

Moreover, whenever a higher price is allowed for one type of crude, a lower price will be required for some other type of crude to meet the composite price. The net effect would be to give FEA increased authority arbitrarily to transfer and allocate as much as $9 billion among various sections of the oil industry.

Lastly, the price roll back on new and stripper well oil would have a far greater impact on independent petroleum producers than on larger companies. The independents drill 9 out of 10 new exploratory wells and make 75% of new field discoveries. IPAA calculations indicate the bill would reduce the independent producers' gross oil revenues 15-20% in the first year alone.

Ultimate Decontrol -- The bill postpones the inevitable decision on price decontrol. Postponing decontrol will merely entrench the vested interests created by economic distortions resulting from controls and continue extensive controls over the petroleum industry contrary to your general policy to minimize governmental interference in the private sector of the economy.

In addition, most analyses of the effects of the bill suggest that (1) the gap between the U.S. domestic oil price and the world oil price will be the same (if not greater) at the end of 40 months and (2) the impact of the end of decontrol on gasoline prices and the economy will be larger in 1979 than now. These factors all suggest that it is highly unlikely that controls would be allowed to automatically expire at the end of 40 months. Thus, I believe that, if you sign the bill, price controls on oil will become permanent as in the case of natural gas.

U.S. International Energy Objectives -- While formalizing our participation in the International Energy Program, the authority contained in the bill is not absolutely essential for the U.S. to satisfy most of its obligations under the international emergency oil sharing program. In addition, the bill works against two of the basic goals of IEA -- fostering conservation and the development of alternative energy sources.

Vulnerability to OPEC -- The conference bill would strengthen OPEC and increase U.S. dependence on OPEC oil at a time when many OPEC countries are having a difficult time marketing their crude output. The bill would lessen U.S. responsiveness to an OPEC price increase and mean that each increase in OPEC price would be met by a smaller decrease in U.S. imports from OPEC than if we had decontrol.

Indexation -- The bill accepts the concept of indexation of oil prices by relating prices to a GNP deflator. We have strongly opposed this concept when OPEC has suggested indexing its prices. Approval of the bill would make it difficult, if not impossible, for us to avoid accepting indexation of OPEC oil prices and an extension of the concept to other commodities -- e.g. coffee, copper and bauxite.

William E. Simon

William E. Simon

12/15 do not make any copies per [illegible]

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

December 12, 1975

OFFICE OF THE ADMINISTRATOR

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB

SUBJECT: ENERGY POLICY AND CONSERVATION ACT

Attached is a copy of the Energy Policy and Conservation Act of 1975. Although the drafting of the statutory language and Conference Manager's Report took four weeks, the delay was largely due to the heavy involvement of FEA staff with Congressional staff in fine tuning all of the language. It is fair to say that the FEA staff lost virtually no issues with the Congressional staff in the drafting process. As Paul Fannin said at the Leadership meeting this week, we perhaps got even a "better" bill than the Conference Committee entitled us to when the actual language was finally in print.

The bill is scheduled for floor action in the House as early as today, but probably Monday. Senate action is scheduled as soon as the House has acted.

Your advisors are continuing to review the bill. The votes of those who have completed their review is provided in the attachment.

Attachment

VOTES OF ADVISORS

ENERGY POLICY AND CONSERVATION ACT

<u>Advisors Favoring Signing</u>

Zarb
Morton
Seidman
Cannon
Seamans
Train
Scowcroft

<u>Advisors Favoring a Veto</u>

Simon
Greenspan
Kleppe
Coleman (if some method of controlling oil prices can be assured to avoid impact of complete decontrol on transportation industry)

<u>Others</u>

Kissinger -- has already discussed his views with you

Lynn -- still reviewing bill

Date: 12/16/75

Office of the Administrator

To: The President

You requested the attached.

Frank Zarb

Federal Energy Administration

Room 3400 Ext. 6081

The New York Times DEC 15

U.S. Oil Drilling Surges on Higher Prices

By WILLIAM D. SMITH

Oil-drilling activity in the United States has surged to its highest level since 1962, with almost every rig that will turn being used.

The impetus behind the drilling resurgence has been the higher price for oil brought on by the sharp increases initiated by the Organization of Petroleum Exporting Countries since 1973. Although American oil prices are not set by OPEC, the 40 percent of this nation's oil that is not controlled in price by the Federal Government has tended to rise to slightly below the level of foreign oil delivered to the United States. Present decontrolled oil prices range near the $13-a-barrel level.

The growth of drilling activity has not reversed the downward trend of domestic oil production but it does appear to have slowed the rate of decline, according to the industry's latest statistics.

In the week ended last Friday 1,785 rigs were in action, according to a Hughes Tool Company survey. This was down from the previous week when 1,800 rigs were in action, the first time the Hughes count had hit 1,800 since January 1962.

In the year-ago week, 1,664 rotary rigs were in operation.

American Petroleum Institute figures show that completions were up to 30,803 in the first 10 months of this year, a 16 percent advance over the 1974 pace. The A.P.I.'s 10-month total comprises 12,902 oil wells, 5,894 gas wells, 10,565 dry holes and 1,442 service and other type wells.

The footage drilled was also up sharply, reaching 142 million feet in the first 10 months, compared with 126.2 million feet in the comparable period of 1974.

Another indicator of the frenzy in oil exploration is the fact that wildcat completions were up 6 percent, totaling 7,495 for the first 10 months of this year.

The oil industry estimates that it will drill between 35,000 and 36,000 wells in the United States this year if the present trend continues.

The step-up in drilling activity has occurred despite the repeal of the 49-year-old depletion allowance last March. At that time many independent operators said they might withdraw from drilling because of the loss of this tax advantage, and some of the major oil companies indicated that it would inhibit their exploration programs. Figures disclose, however, that rig activity barely faltered after elimination of the depletion allowance and then quickly regained momentum.

In the week ended Dec. 5 domestic crude oil production in the United States totaled 8.2 million barrels a day. This compared with 8.3 million barrels a day a week earlier and 8.69 million barrels a day in the comparable week of 1974.

Last January production totaled 8.4 million barrels a day, so the present level of production is a 2 percent decline since the first of the year. Production in January 1974 was 8.9 million barrels a day.

United States production peaked in November 1970 at 10 million barrels of oil a day.

A great deal of the present drilling is in areas already worked over. The new wells are going deeper, and some oil that was not profitable at lower prices is now being brought into production.

It remains uncertain, however, whether the frenzy of drilling be able to reverse the downward trend of domestic oil production.

10

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461
DEC 16 1975

OFFICE OF THE ADMINISTRATOR

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB

THROUGH: ROGERS C. B. MORTON

SUBJECT: BIWEEKLY STATUS REPORT

The major industrialized nations have all experienced warmer weather so far this heating season, putting downward pressures on world heating oil prices. Through November 29, the United States had 24.7 percent fewer degree days (warmer weather) than during the same period last year. In Japan, weather for October and November was 21.9 percent warmer (fewer degree days) while western Europe had 18.7 percent fewer degree days through October than last year.

Residual fuel oil demand, at 2.32 million barrels per day, is 729,000 barrels per day (23.9 percent) below last year and below FEA's forecast. Distillate demand, however, despite the relatively warm weather, was 2.92 million barrels per day (7.2 percent) below last year and just slightly below the forecast.

The level of residual fuel oil demand appears to be a statistical anomaly. Residual demand is relatively unaffected by weather conditions and demand at steam electric plants (about half of the total) has remained constant from the previous year.

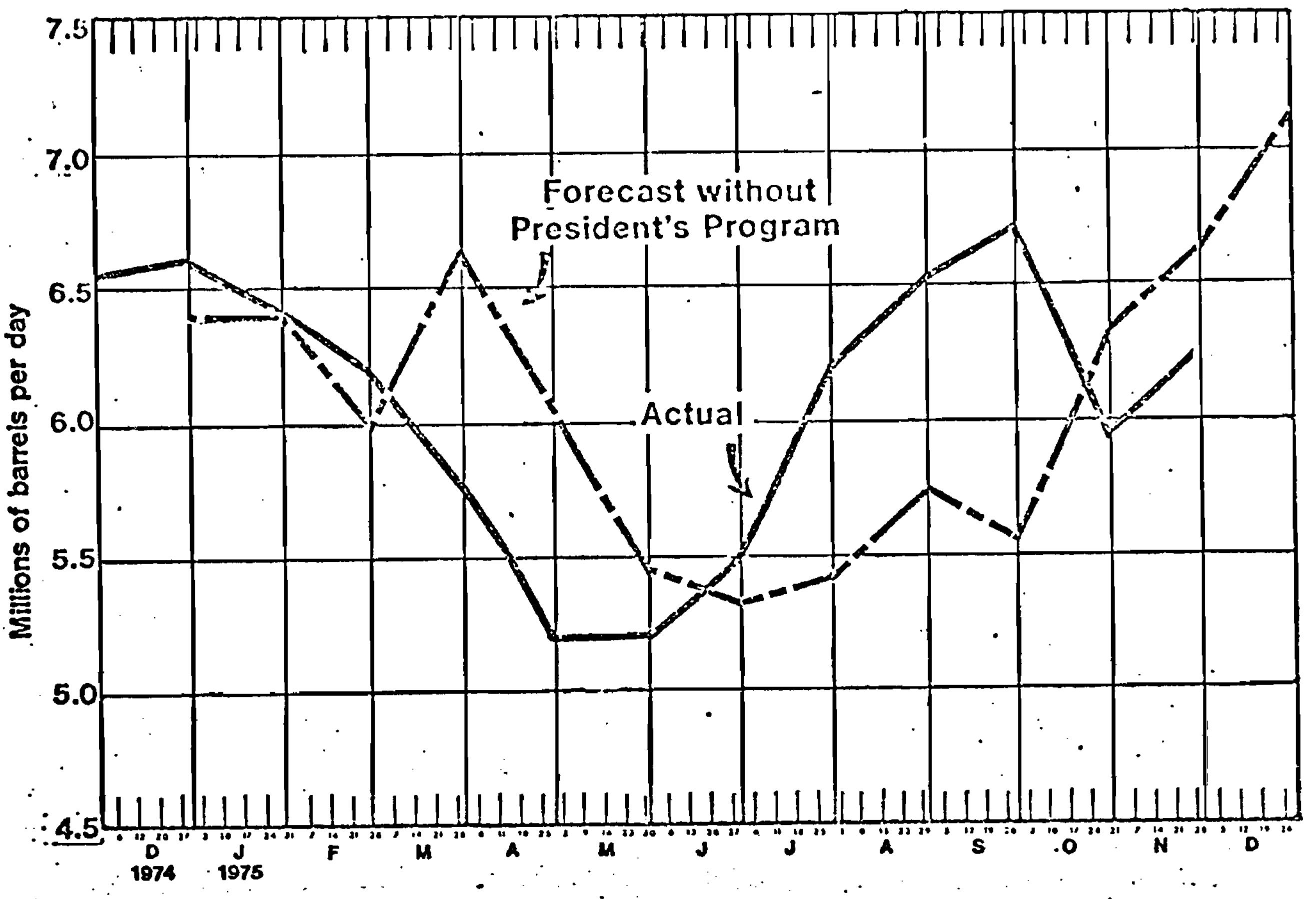
Motor gasoline demand continues at about the same level as last year and 1973.

Domestic crude oil production, at 8.28 million barrels per day, has dropped slightly below the March level of 8.39 and is now only 3.4 percent below November 1974.

Quarterly Report on Mid-Term Goals

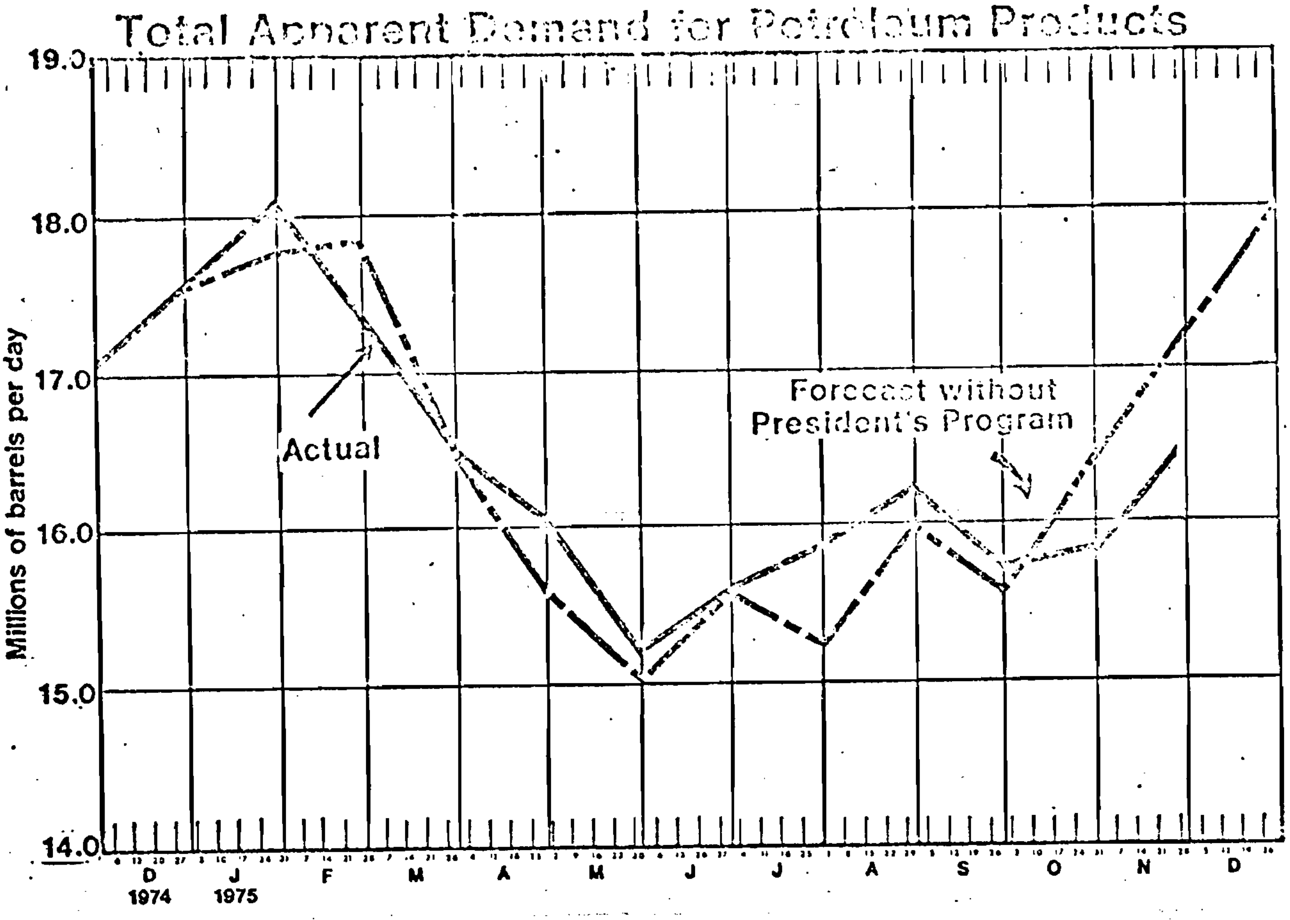
The third quarterly report on progress toward your Mid-Term goals is included with this report.

Total U.S. Petroleum Imports (Crude and Product)



- For the 4 weeks ending November 28, total imports averaged 6.24 million barrels per day, up 118 thousand barrels per day from the period ending November 14. This was 717,000 barrels per day below the 1974 level, and 91,000 below 1973.

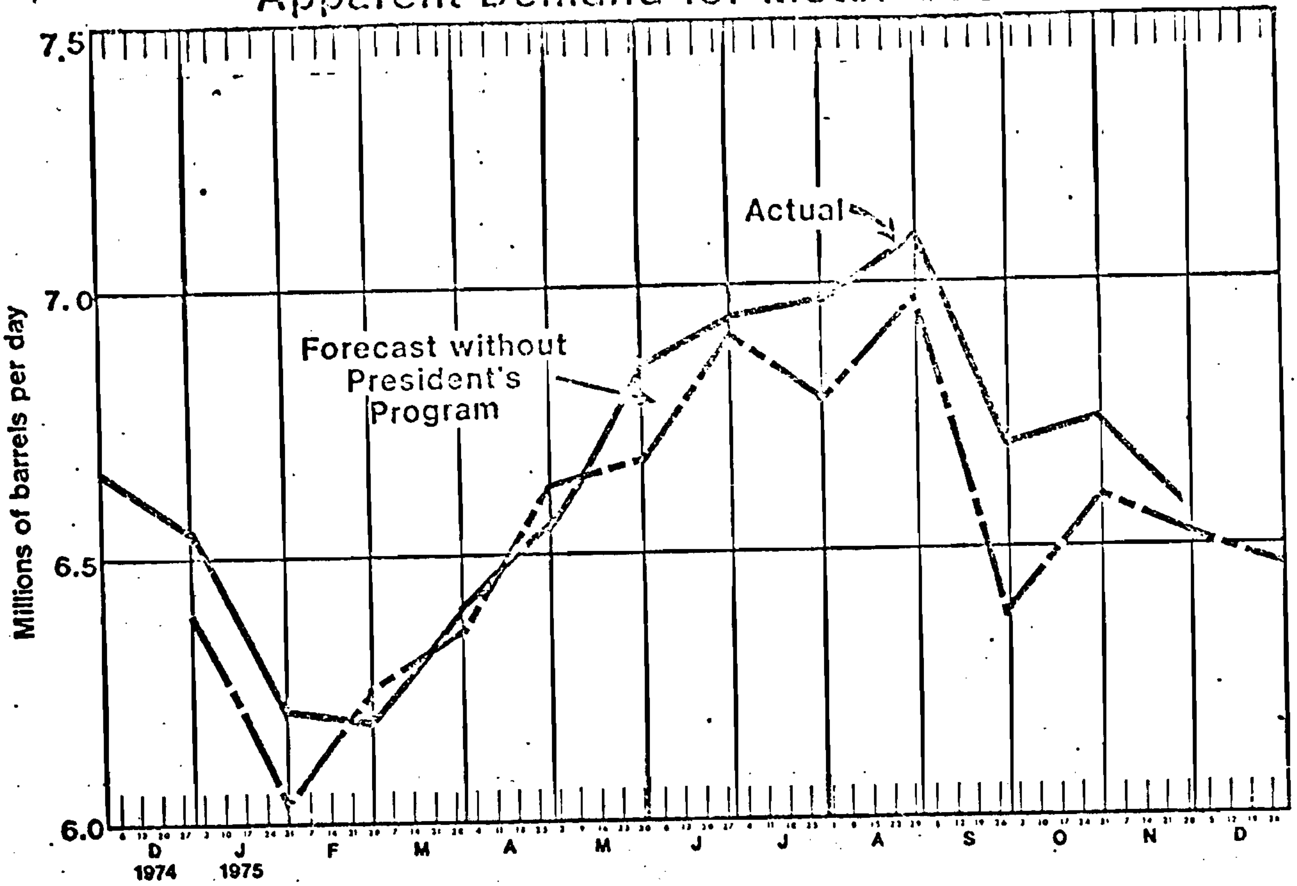
Figure 2



o **Total** apparent demand during the 4 weeks ending November 28, was **16.46** million barrels per day, 1.26 million barrels per day below **last** year and one million barrels per day below 1973.

Figure 3

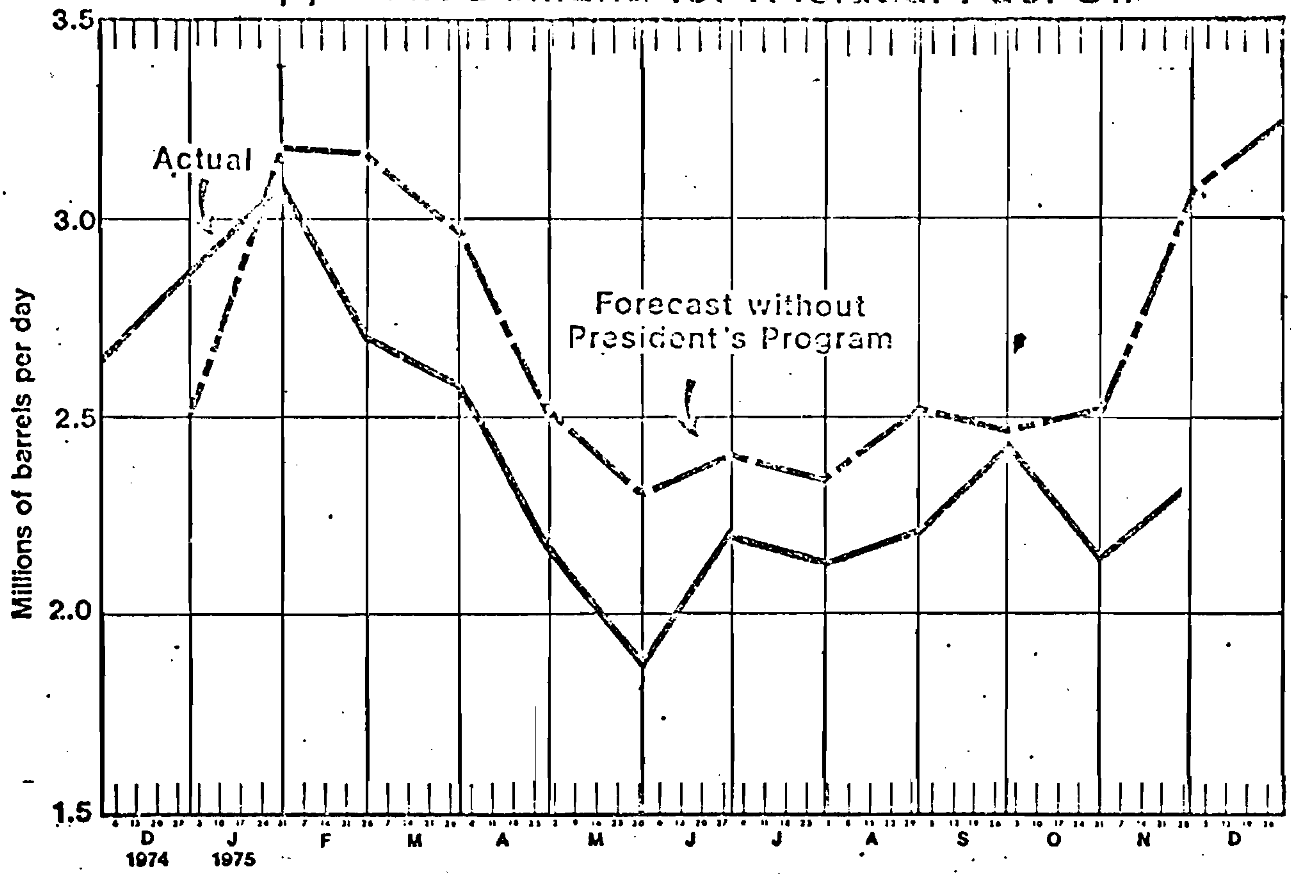
Apparent Demand for Motor Gasoline



- Apparent demand for motor gasoline in the 4 weeks ending November 28, averaged 6.60 million barrels per day, slightly above last year and 1973.

Figure 4

Apparent Demand for Residual Fuel Oil

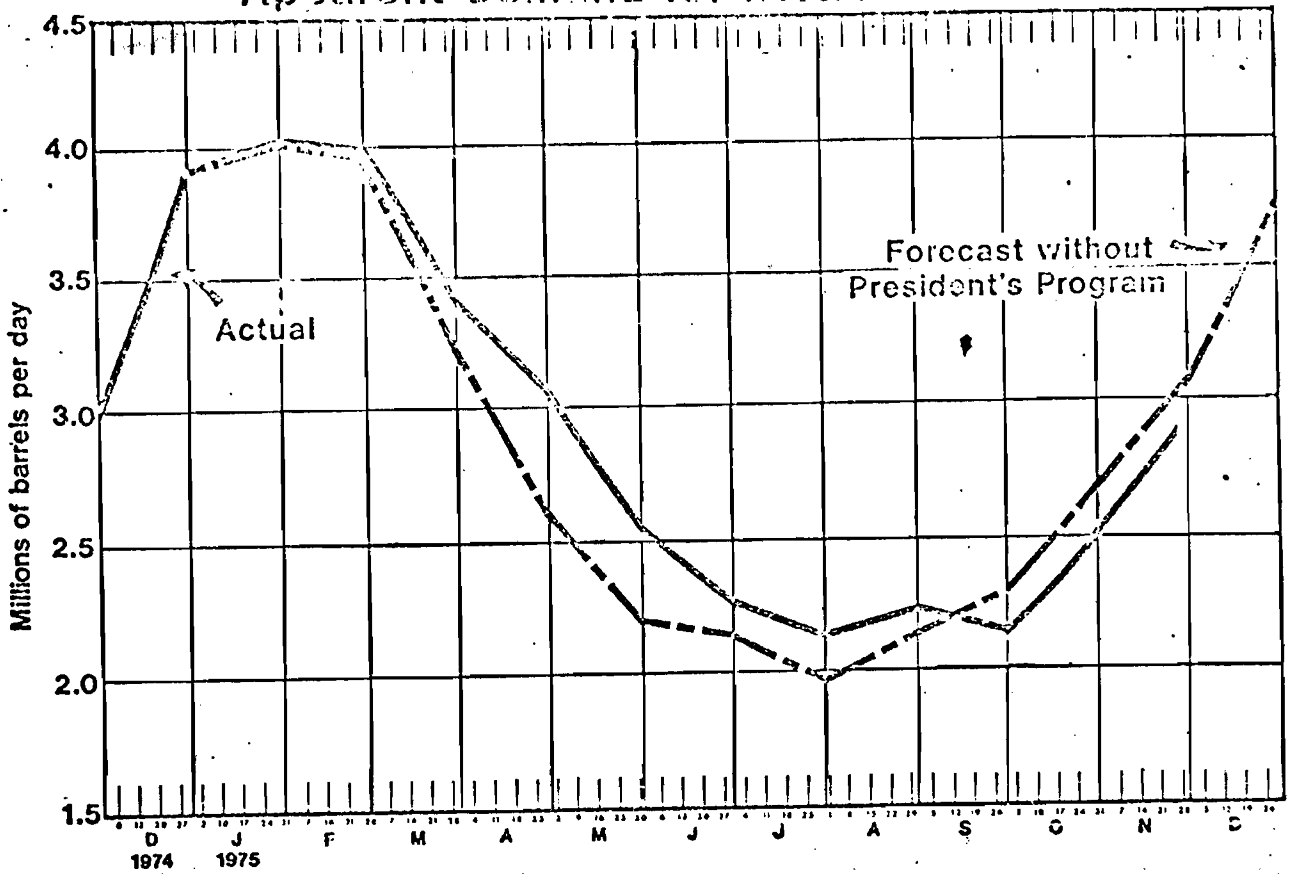


o For the 4 weeks ending November 28, apparent demand for residual fuel oil was 2.32 million barrels per day. This was 729,000 barrels per day below last year, and 530,000 below 1973.

This level of demand is 720,000 barrels per day below the forecast and is difficult to explain, having regard to the fact that electric power demand, about half of the total, is running about the same level as last year.

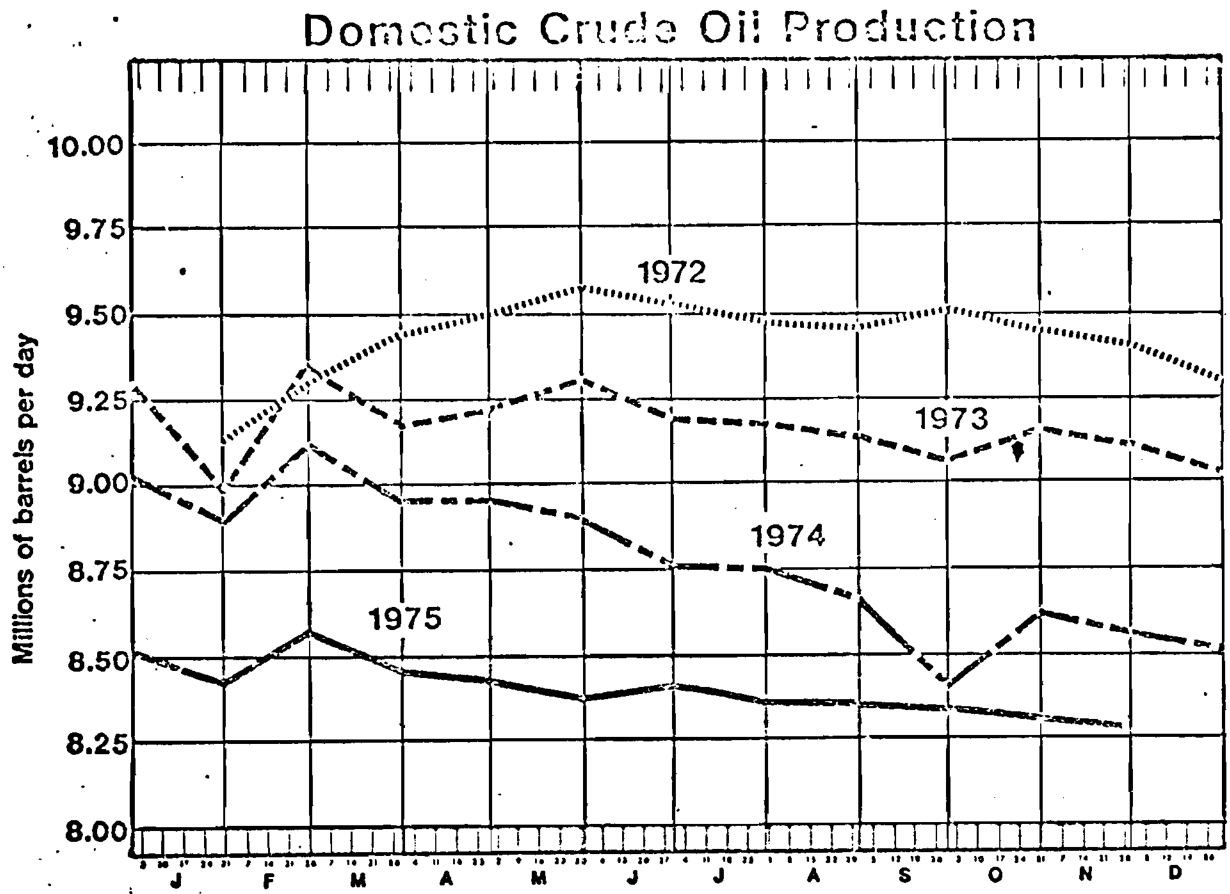
Figure 5

Apparent Demand for Distillate Fuel Oil



o Apparent demand for distillate fuel oil for the 4 week period ending November 28, was 2.92 million barrels per day, 229,000 barrels per day less than last year and 484,000 below 1973.

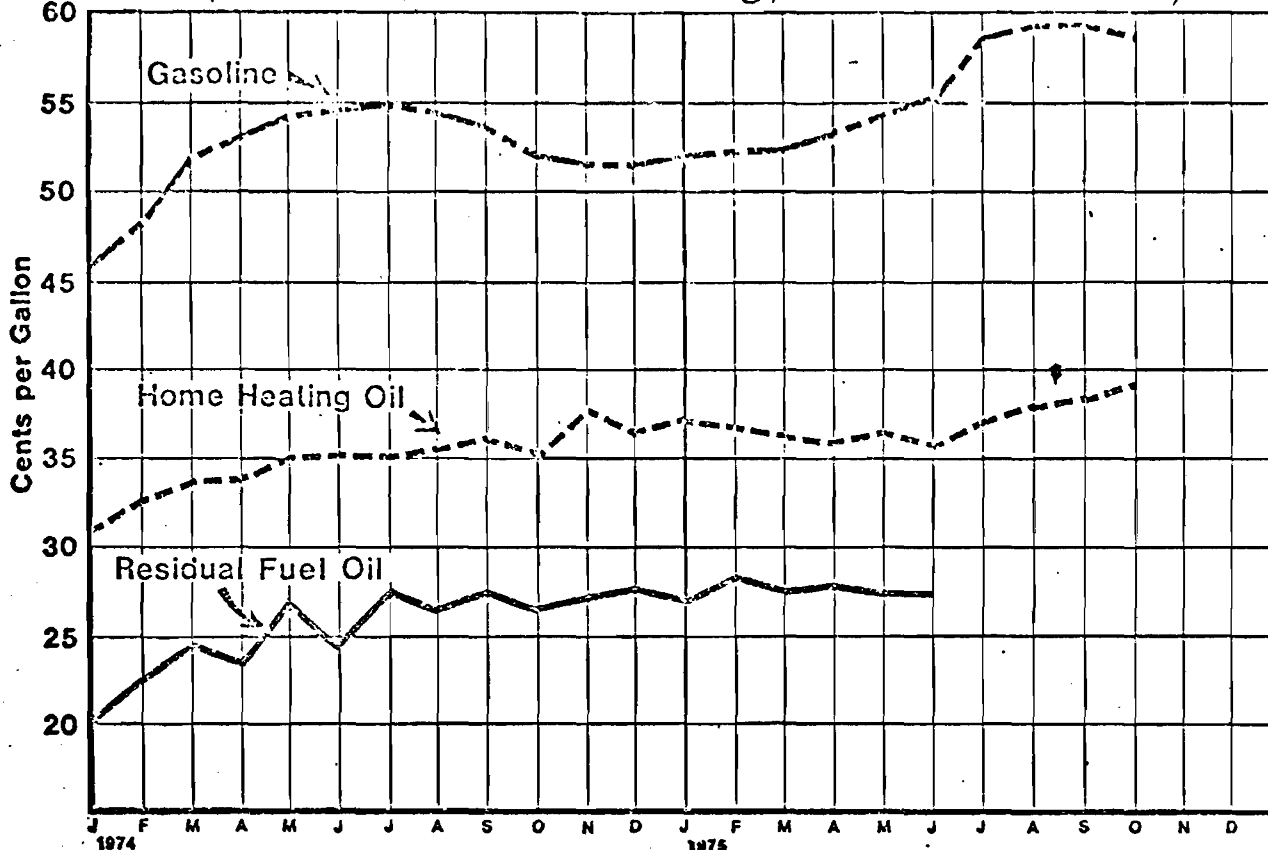
Figure 6



- o Production of crude oil for the 4 weeks ending November 28, was 8.28 million barrels per day, according to API estimates, 3.4 percent and 9.7 percent below the corresponding 1974 and 1973 BOM figures.

Figure 7

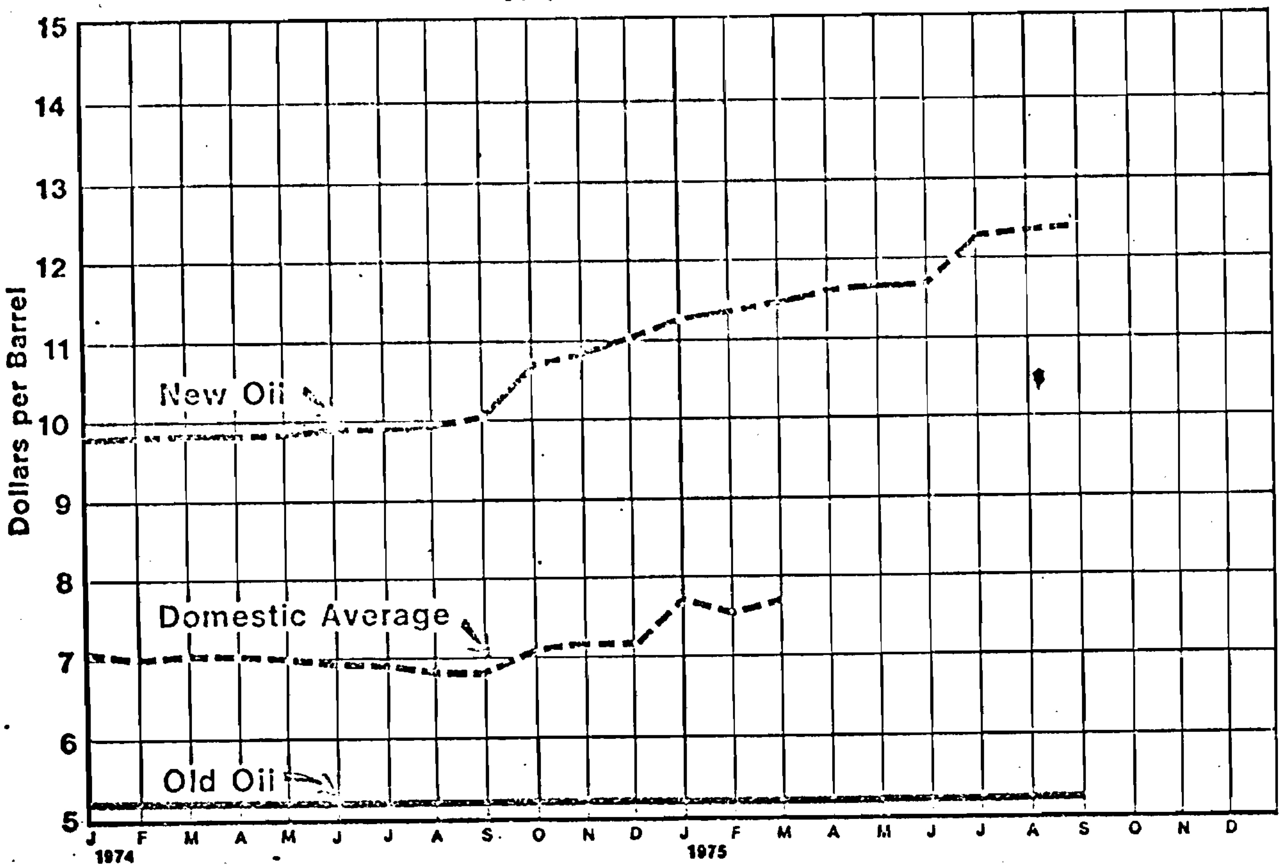
Retail Prices
(Gasoline, Home Heating, Residual Fuel Oil)



(no new data since last report)

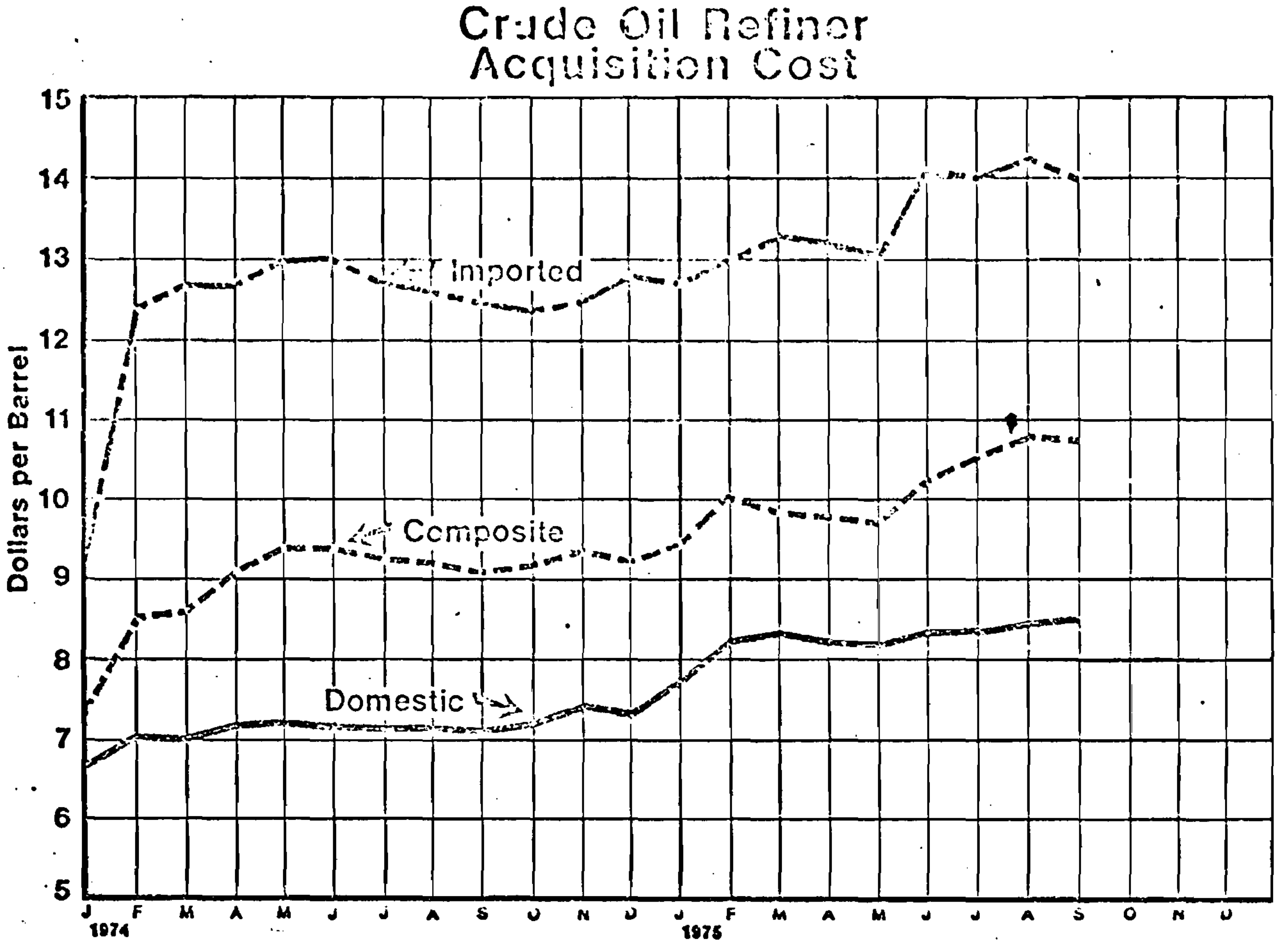
Figure 8

Crude Oil Wellhead Price



(no new data since last report)

Figure 9



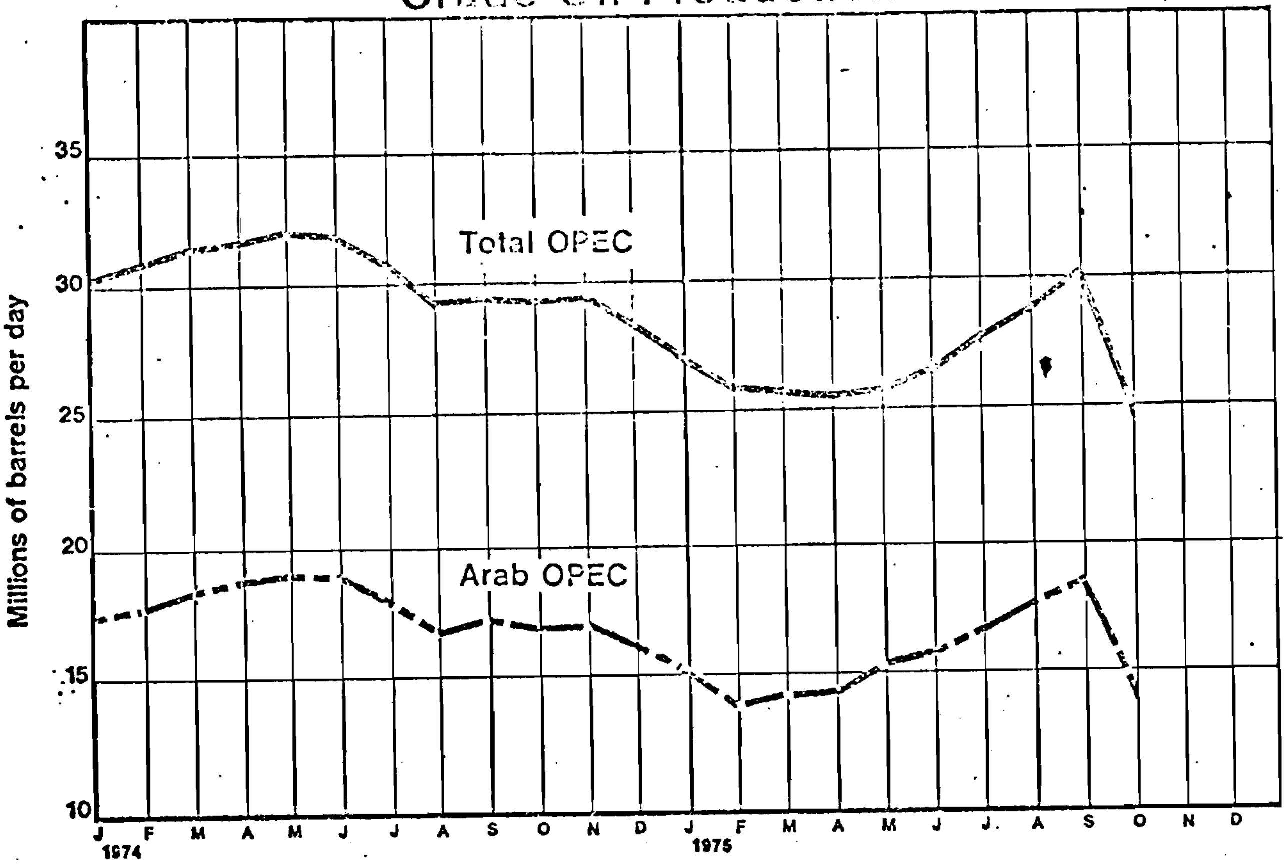
- The refiner acquisition cost of imported crude during September was $14.04 per barrel, 21 cents below the August figure of $14.25. This drop can be attributed to an increase in the percentage of crude purchases from countries with lower prices.

  The average cost of domestic crude purchased by refiners during September remained relatively unchanged, increasing by only 0.1 cent to $8.49 per barrel.

  The composite cost of crude petroleum to refiners during September was $10.79 per barrel, 2 cents below the August figure.

Figure 10

OPEC Countries Crude Oil Production



(no new data since last report)

DEFINITIONS

Apparent Demand -- Domestic demand for products, in terms of real consumption, is not available; inputs to refineries plus estimated refinery gains; plus net imports of products plus or minus net changes in primary stocks of products are used as a proxy for domestic demand. Secondary stocks, not measured by FEA, are substantial for some products.

Actuals -- Monthly data through October from FEA's Monthly Petroleum Reporting System, and 4-week moving average from the API Weekly Statistical Bulletin for 4 weeks ending November 28 (figure 1). Demand after October estimated for figures 2, 3, 4, and 5 by FEA primarily from the API Bulletin. Figure 6, BOM through July, 1975; FEA monthly for August, September and October; API 4-week moving average for period ending November 28. Figures 7, 8, 9, and 10 from FEA.

Forecast -- A petroleum product demand forecast is made, based on a projection of the state of the economy, without implementation of the President's conservation program, and on the expectation of normal weather. The forecast is periodically revised to take account of actual weather and revised macroeconomic forecasts.

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

OFFICE OF THE ADMINISTRATOR

December 17, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB

SUBJECT: RESULTS OF 1976 COMBINED FEDERAL CAMPAIGN

Our Bicentennial fund-raising efforts officially end tomorrow, and I will publicly announce total receipts and pledges to date which exceed our $9.5 million goal.

In recent years, CFC has collected almost $500,000 after the final report meeting, but prior to the closing audit. A large part of this sum comes from overseas contributors of Federal departments and agencies. We expect to receive at least 15,000 additional contributions from these and other sources. In all likelihood, we will exceed our goal and reach $10 million, a new CFC record, before the final audit early in 1976.

Reaching this goal took a good deal of work on the part of key Cabinet Members. We will be drafting letters for your signature thanking them for their extra work and good success.

ORP/JAskew/12/17/75
Rewritten:FGZarb 12/17/75

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

OFFICE OF THE ADMINISTRATOR

December 20, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB /s/
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.

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461
DEC 24 1975

OFFICE OF THE ADMINISTRATOR

MEMORANDUM FOR THE PRESIDENT

FROM: FRANK G. ZARB

THROUGH: ROGERS C.B. MORTON

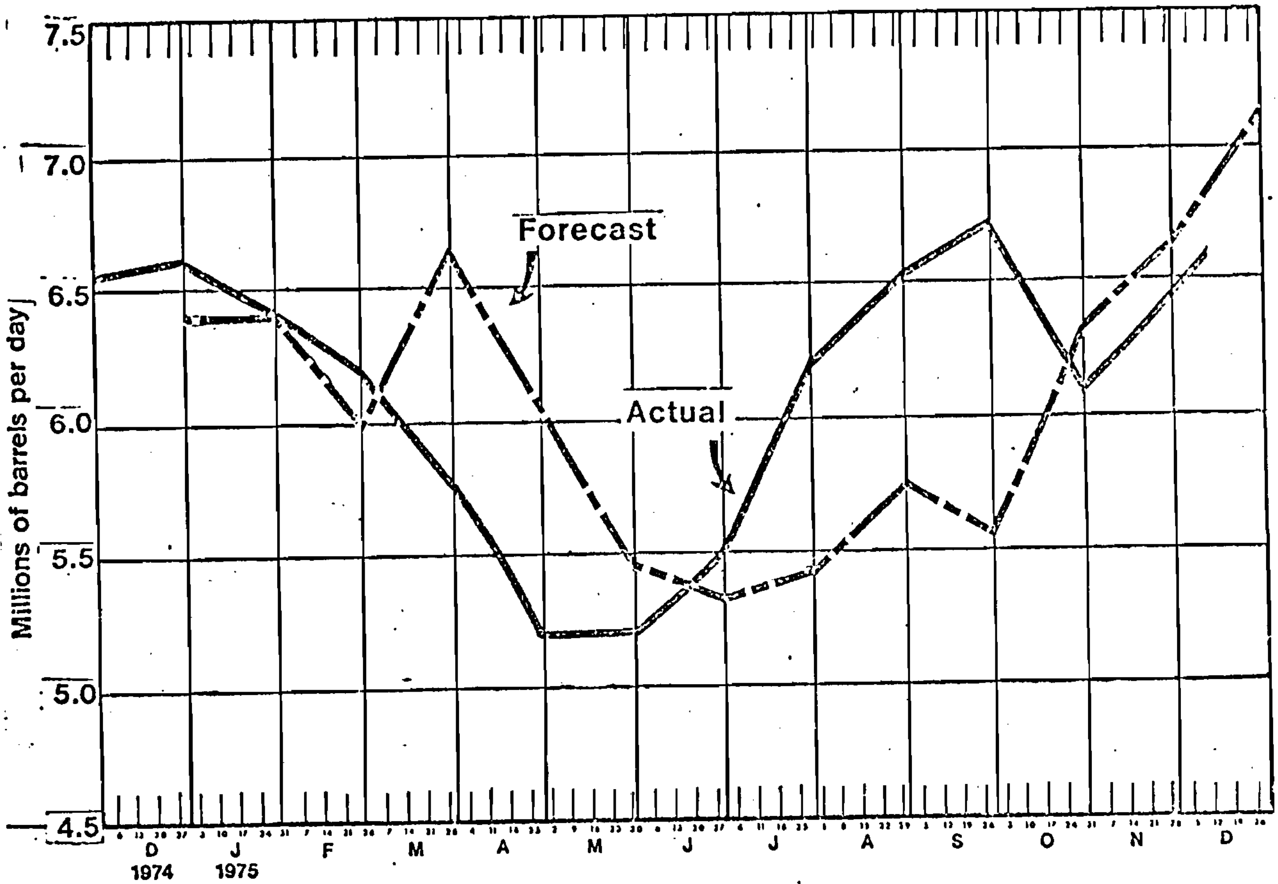
SUBJECT: BIWEEKLY STATUS REPORT

Apparent demand for residual fuel oil increased 223,000 barrels per day (9.7 percent) for the four weeks ending December 12. This level is still considerably lower (15.0 percent) than last year despite the fact that industrial production continues to rise.

Much of the drop in apparent demand for residual fuel oil is attributable to the extremely warm fall weather experienced by most of the Nation. The autumn has been particularly warm on the East Coast, the area where most fuel oil is consumed, as cumulative degree days since September 1 have declined by 27.3 percent from the previous year. The warmer weather has also reduced expected curtailments of natural gas supply to industry and the utilities, thus compounding the effect upon residual demand.

The actual consumption of residual fuel oil could be higher than estimated "apparent" demand which is derived from refinery output, imports and changes in primary stocks held by the oil companies. In addition, it is believed that industry and the utilities increased their secondary storage during the July-September period before the OPEC price increase, and may be drawing down such storage at this time.

Total U.S. Petroleum Imports
(Crude and Product)

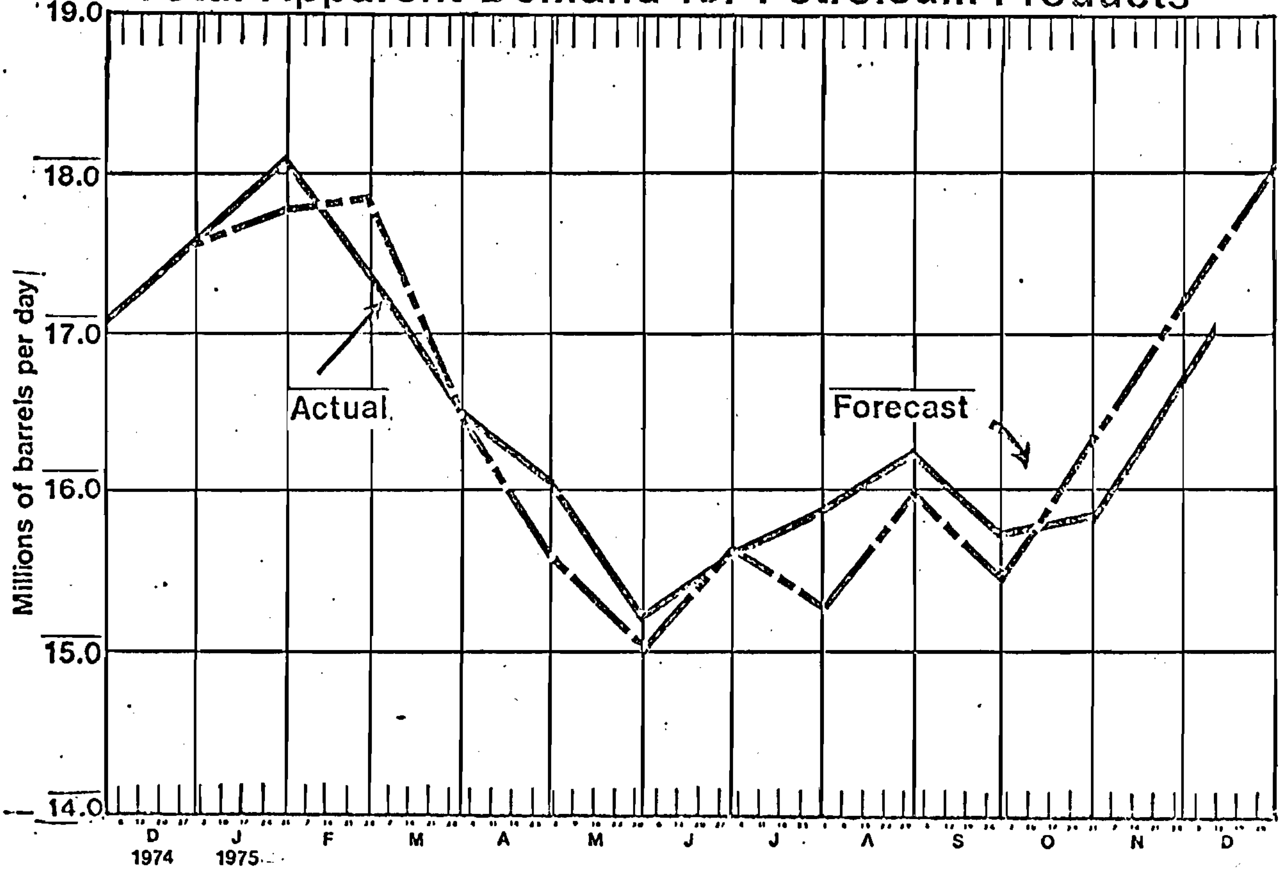


o For the 4 weeks ending December 12, total imports averaged 6.61 million barrels per day, up 210,000 barrels per day from the period ending November 28. This was 380,000 barrels per day below the 1974 level, but 450,000 above 1973, during the embargo.

o The figure makes it clear that imports were unseasonably high during the period July through September, just before the OPEC price increase. To the extent that such imports caused a buildup during this period of secondary storage, not covered in our data, followed by a drawdown in October through December, demand would be overestimated in the former period and underestimated in the latter.

Figure 2

Total Apparent Demand for Petroleum Products

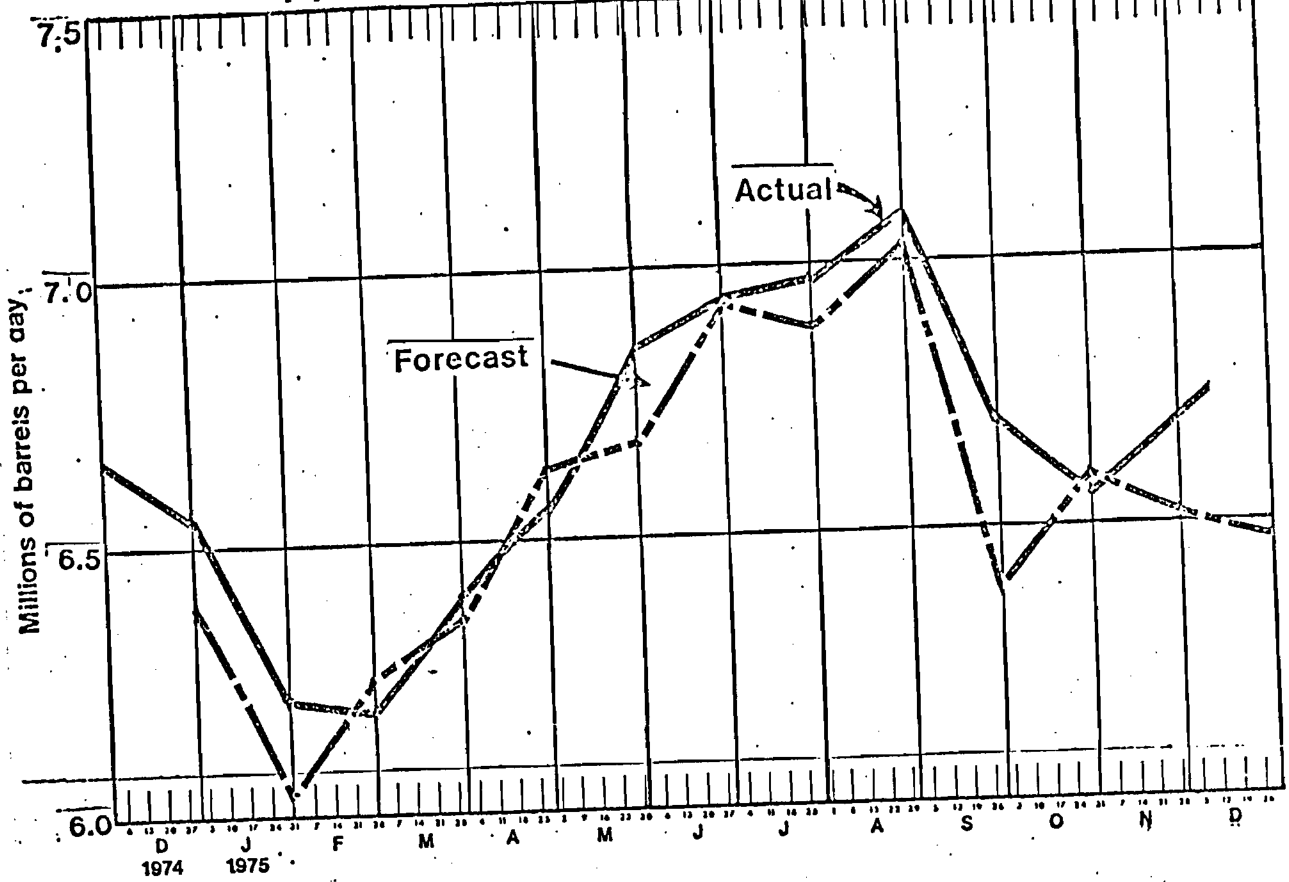


- Total apparent demand during the 4 weeks ending December 12 was 17.08 million barrels per day, 1.0 million barrels per day below last year and 450,000 barrels per day below 1973.

- As noted in the comments on Figure 1, variations in imports and secondary storage between July-September and October-December, may have caused an overestimation of demand in the former period and an underestimation in the latter, particularly in the case of the fuel oils for which industrial and utility customers have considerable storage capacity.

Figure 3

Apparent Demand for Motor Gasoline

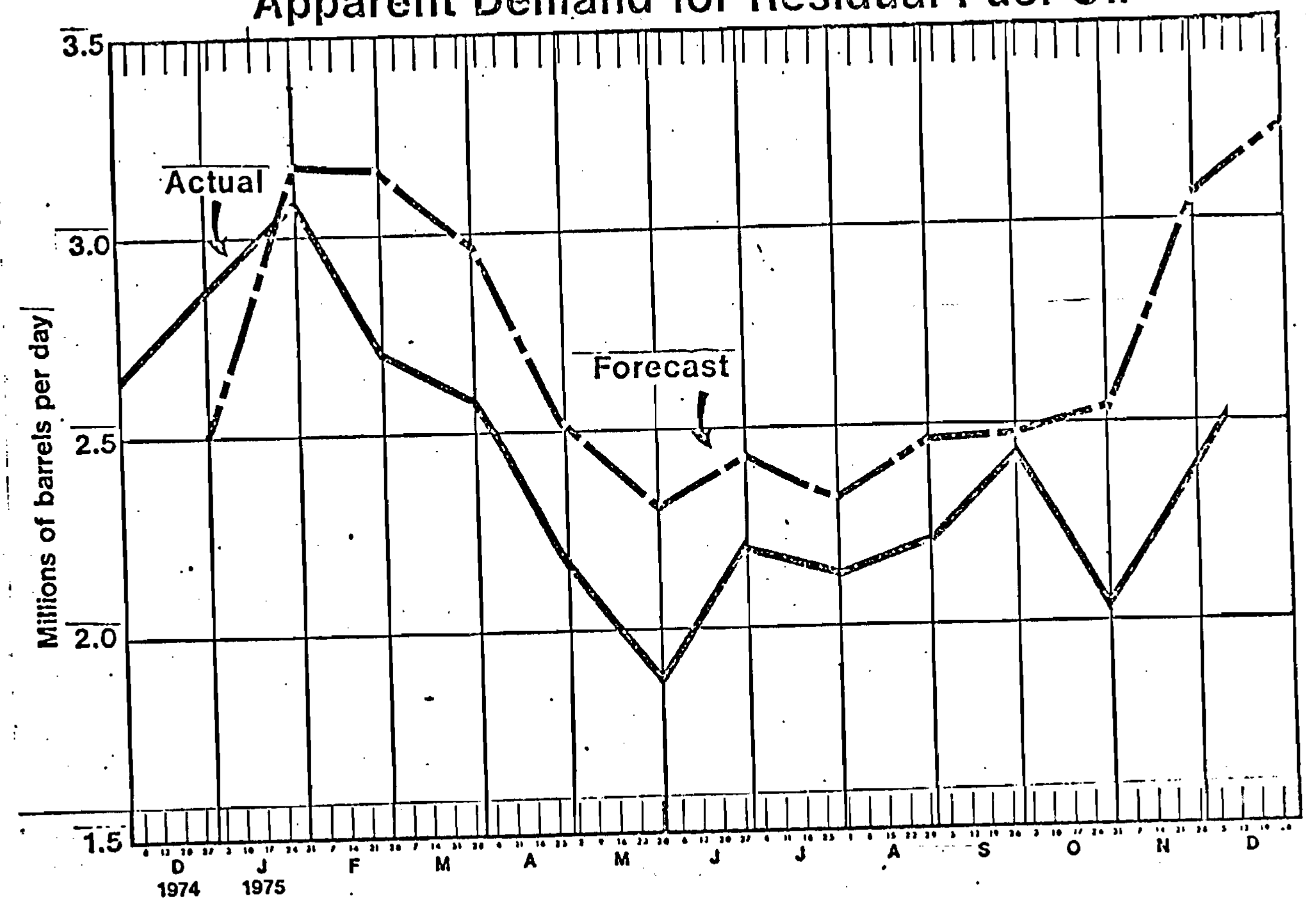


- o Apparent demand for motor gasoline in the 4 weeks ending December 12 averaged 6.75 million barrels per day, 170,000 barrels per day above last year and 370,000 barrels per day above 1973.

- o The warmer fall weather has undoubtedly contributed to the relatively high level of gasoline demand.

Figure 4

Apparent Demand for Residual Fuel Oil

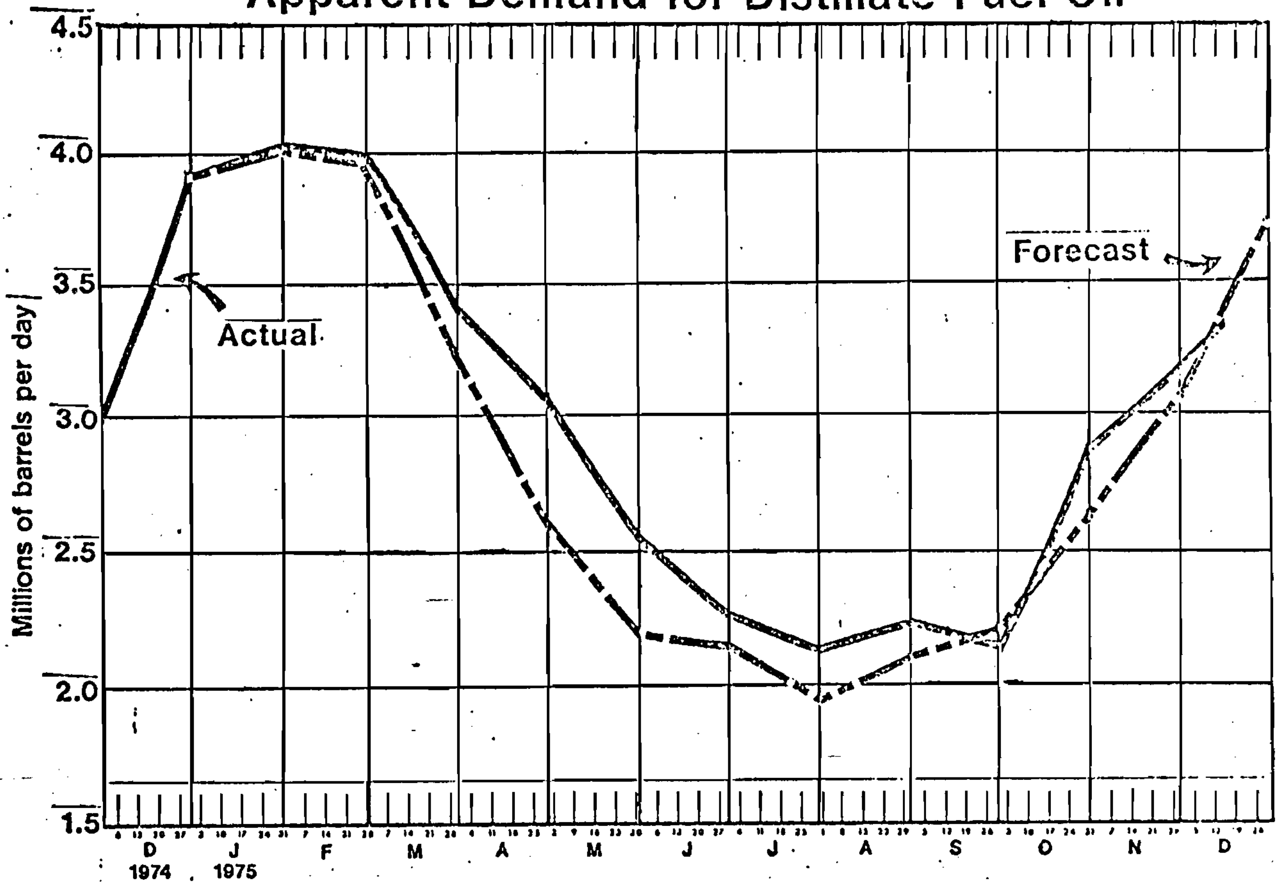


- For the 4 weeks ending December 12, apparent demand for residual fuel oil was 2.53 million barrels per day. This was 450,000 barrels per day (15.0 percent) below last year, and 400,000 below 1973.

- The covering memorandum suggests a number of reasons for the low level of demand.

Figure 5

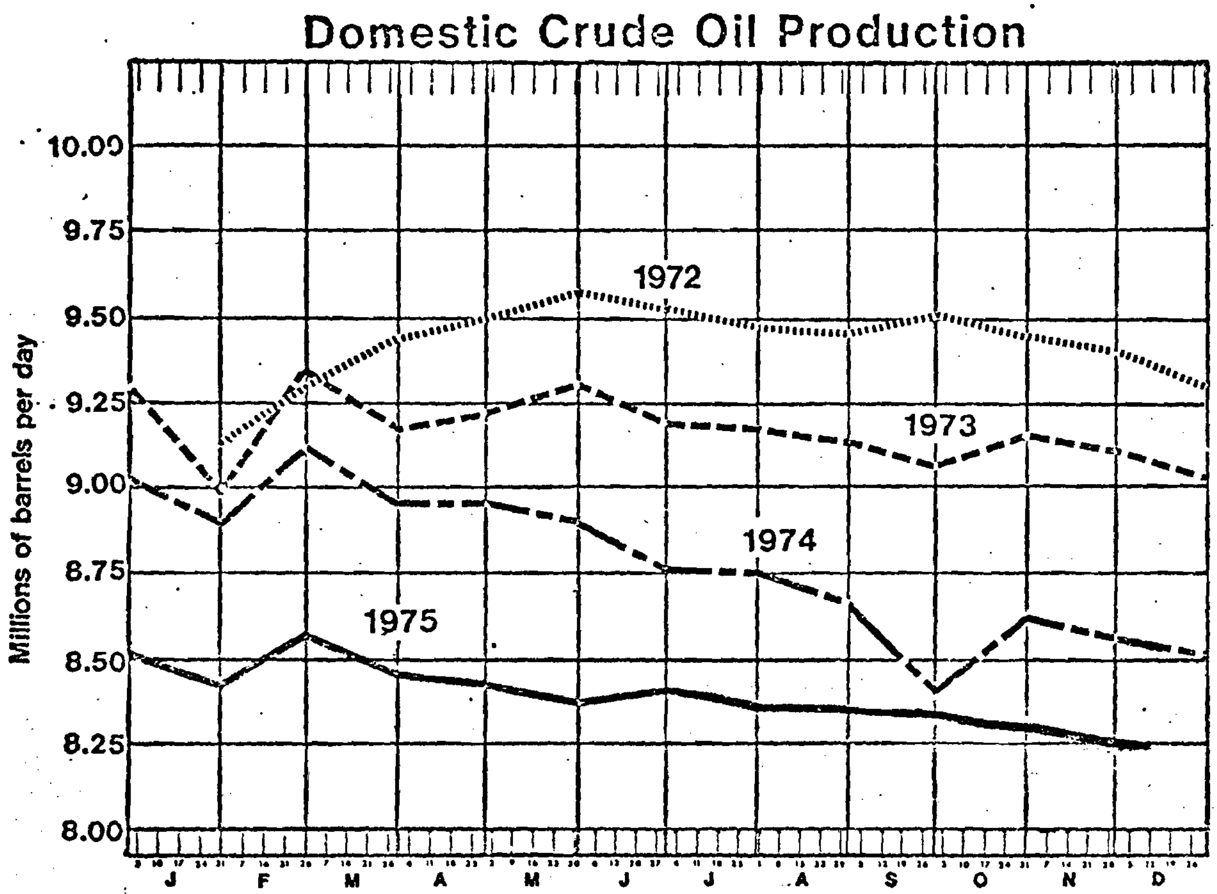
Apparent Demand for Distillate Fuel Oil



- o Apparent demand for distillate fuel oil for the 4 week period ending December 12 was 3.36 million barrels per day, 170,000 barrels per day less than last year and 130,000 below 1973.

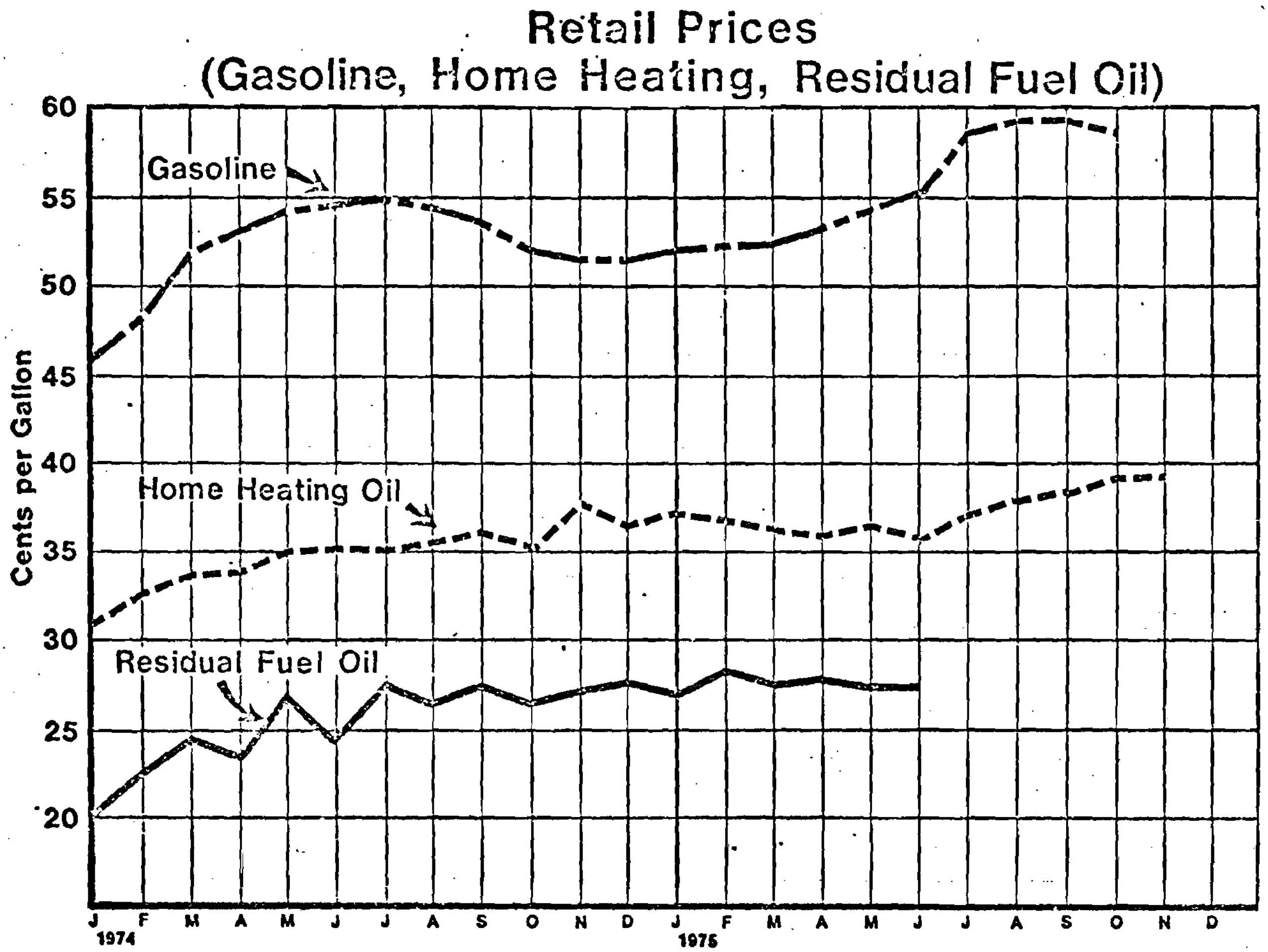
- o Despite the unusually warm weather, demand was right on the forecast which, of course, assumed normal weather. This suggests that there may be considerable substitution of distillate for residual fuel oil.

Figure 6



- Production of crude oil for the 4 weeks ending December 12 was 8.25 million barrels per day, according to API estimates, 3.4 percent and 9.5 percent below the corresponding 1974 and 1973 BOM figures.

Figure 7

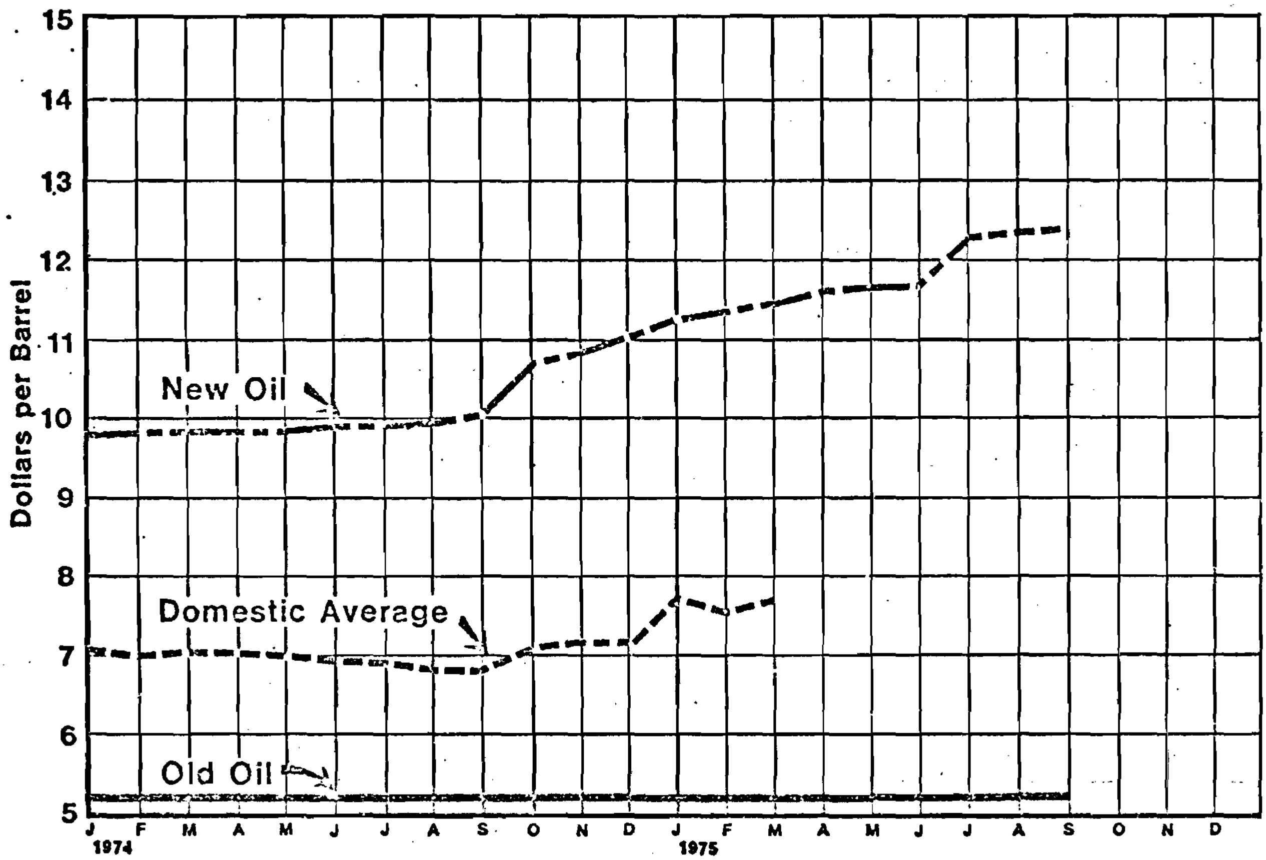


- Gasoline (no new data since last report).

- Residual Fuel (no new data since last report).

- During November, the average retail price of heating oil sold to residential customers was 39.4 cents per gallon, up slightly, by 0.1 cent, from the October figure. Prices were held relatively stable because of ample supplies in storage.

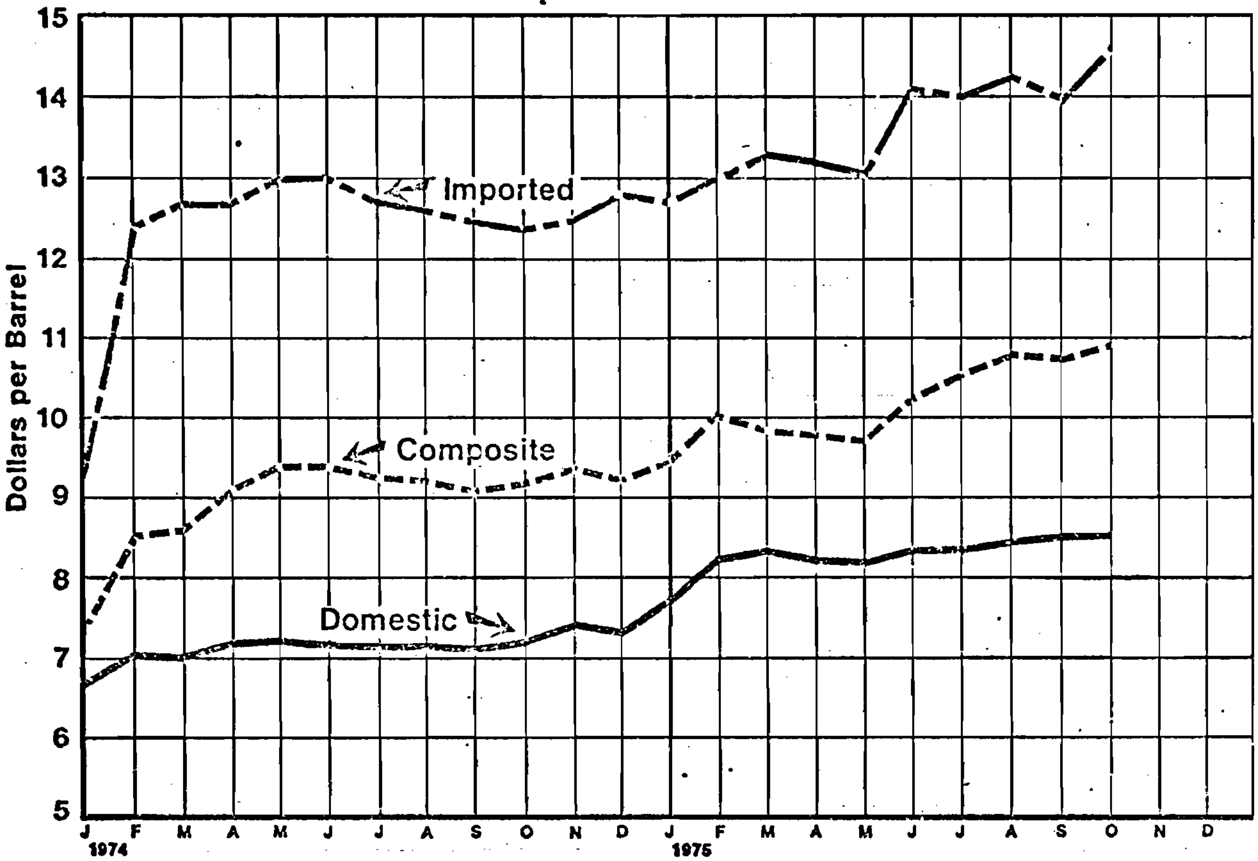
Figure 8
Crude Oil
Wellhead Price



(no new data since last report)

Figure 9

Crude Oil Refiner Acquisition Cost



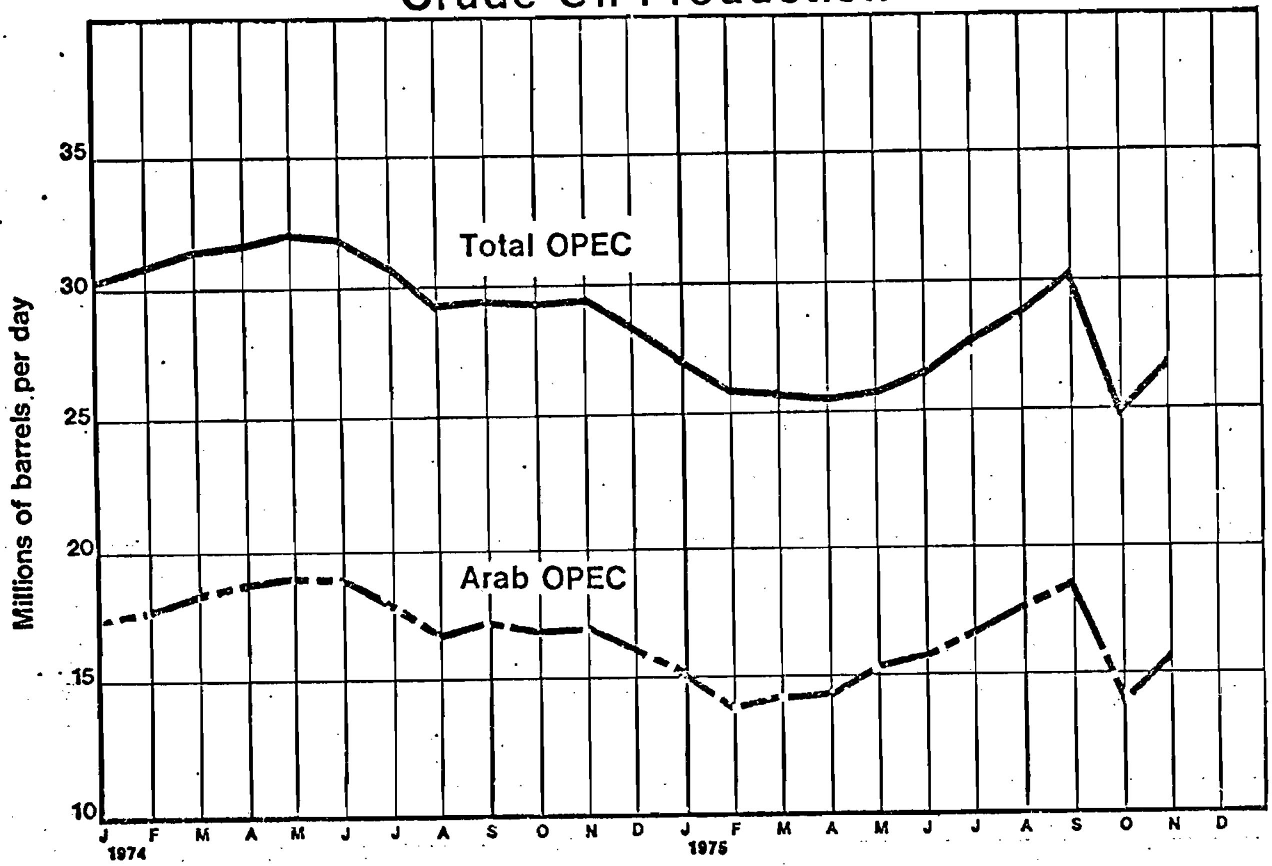
- o The refiner acquisition cost of imported crude during October was $14.66 per barrel, 62 cents above the October figure. This increase can be attributed to the October OPEC increase.

- o The average cost of domestic crude purchased by refiners during October increased 10 cents per barrel over the September figure. This price now stands at $8.59 per barrel.

- o The composite cost of crude petroleum to refiners during October was $10.95 per barrel, 16 cents above the September figure.

Figure 10

OPEC Countries Crude Oil Production



o Preliminary data indicate that total OPEC crude oil production rose to about 27 million barrels per day in November. This essentially equals the 1975 11-month average. Arab member production of 16.2 million barrels per day represented 60.1 percent of the total compared to 57.6 percent in October, as Saudi Arabia accounted for most of the increase.

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