

The original documents are located in Box 4, folder: “Testimony, June 29, 1976, House Interstate and Foreign Commerce Committee - Subcommittee on Energy and Power” of the Frank Zarb Papers at the Gerald R. Ford Presidential Library.

Copyright Notice

The copyright law of the United States (Title 17, United States Code) governs the making of photocopies or other reproductions of copyrighted material. Frank Zarb donated to the United States of America his copyrights in all of his unpublished writings in National Archives collections. Works prepared by U.S. Government employees as part of their official duties are in the public domain. The copyrights to materials written by other individuals or organizations are presumed to remain with them. If you think any of the information displayed in the PDF is subject to a valid copyright claim, please contact the Gerald R. Ford Presidential Library.

STATEMENT OF
FRANK C. ZARB, ADMINISTRATOR
FEDERAL ENERGY ADMINISTRATION
BEFORE THE
SUBCOMMITTEE ON ENERGY AND POWER
INTERSTATE AND FOREIGN COMMERCE COMMITTEE
HOUSE OF REPRESENTATIVES
JUNE 29, 1976



Mr. Chairman and Members of the Subcommittee. Thank you for this opportunity to be of further assistance to the Subcommittee in your continuing consideration of Energy Actions Nos. 3 and 4, FEA's proposal to exempt No. 2 oils and other middle distillates from the Mandatory Petroleum Allocation and Price Regulations. I would like briefly to supplement our testimony of June 22 before this Subcommittee in three respects and then be available to answer whatever further questions you may have regarding FEA's proposed exemption of middle distillates.

In particular, it should be noted that since our testimony, FEA has had further discussions with the Chairman and staff of this Subcommittee regarding the demand projections in the findings and views submitted with Energy Actions Nos. 3 and 4. Moreover, FEA has elaborated in greater detail in another communication with the Chairman of the Subcommittee upon the manner in which it would exercise its authority to reimpose controls. Finally, I would like to discuss an action we are taking today to limit domestic crude oil prices to their June levels for a period of two months which I believe is relevant to the matters now under consideration by this Committee.



We will respond in detail to the specific questions raised by the staff regarding FEA's estimates of demand and supply of middle distillates. However, it is important that the Subcommittee understand that none of the slight changes in our demand estimates has been big enough to change the essential conclusion: domestic supply will be adequate to meet increased demand with no appreciable increase in imports.

The demand estimates set out in the Findings and Views were developed in March of 1976 using the latest data available to us at that time. The Findings and Views were then published for public comment and public hearings were held on them on May 12 and 13. While certain persons at those hearings opposed the exemption of middle distillates from controls, there was no evidence offered there that questioned FEA's demand and supply estimates.

Meanwhile, FEA analysts were continuing to improve the short-term forecasting model and more recent data were becoming available. Early in May the results of this improved and updated forecasting model were available, and these were compared to the estimates set out in the Findings and Views. The differences were not statistically significant. Therefore, there was no valid basis for changing the estimates in the Findings and Views. In fact, the later results gave us added confidence that those estimates were sound and



reinforced our belief in the validity of the conclusions drawn from those estimates.

After Energy Actions 3 and 4 had been submitted and a technical paper describing the revised version of the forecasting model had been circulated for comment, we learned two relevant things. First, we got new and updated information from the Federal Power Commission as to the extent of natural gas curtailments expected this winter. Second, we discovered that the way natural gas curtailments were being treated in the revised forecasting model needed to be adjusted.

FEA analysts immediately made the necessary changes in the model, entered the new FPC data on expected curtailments, and generated new middle distillate demand estimates for 1976 through 1978. While these estimates were still within the range of the estimating accuracy of the model itself and could, therefore, be considered not statistically significant, they were slightly higher, especially for 1978, than the estimates in the Findings and Views.

Accordingly, Mr. Hill wrote the Chairman on June 25, the day the revised estimates were made, to be sure that the Subcommittee had the most up-to-date information available to FEA.

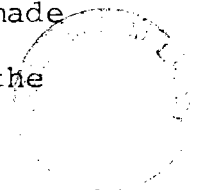


There has been some suggestion that in some way PEA is showing uncertainty or lack of confidence in its estimates by changing them frequently. I think the exact opposite is true. If we were out to make the numbers support a pre-determined conclusion, we would make one estimate and then stick to it throughout the course of the issue.

Instead, we made the estimates, drew the conclusions in the Findings and Views, then continued to improve and update our forecasts. We circulated for staff comment the details of the most recent estimates on the day before submitting Energy Actions 3 and 4. This is not the behavior of an agency that lacks confidence in its work.

Finally, when we get new data and find changes are needed in the technical procedures of the model, we incorporate the new data, change the procedures, and immediately communicate the results to the Subcommittee. Again, this is not the behavior of an agency that is uncertain or secretive about its work. On the contrary, it is the result of a conscious effort at my direction to be completely open and above board as to all of our work and to keep this Subcommittee fully informed of our results.

To conclude my discussion on this point, Mr. Chairman, it is important to note that all of the changes we have made have been small adjustments. Each has been well within the



range of the statistical accuracy of the estimating process itself, and none of the estimates has provided any basis whatsoever for changing the conclusions set out in our Findings and Views.

I would now like to brief the Committee on certain further procedures that we are proposing should the exemption of middle distillates become effective, and that were developed subsequent to John Hill's testimony before you on June 22. These and our previously proposed procedures are described in detail in a letter I delivered to the Chairman of this Subcommittee on June 25.

Specifically, FEA is committing itself to a special contingency plan for distillates with the following key elements:

- a quick response monitoring system on a weekly basis during the heating season (based on FEA's current reporting system and telephone surveys) that will compare actual prices on a weekly basis with projections of what prices would have been if regulatory controls were still in effect;
- specific obligation of the Agency to take certain actions if prices in the decontrolled market reach the index amount, i.e., exceed by more than 2 cents the projections of what they would have been with continued controls; and

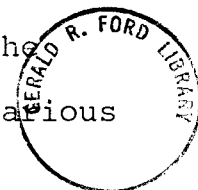
- an emergency allocation system to insure that no marketer loses his supplies without adequate time to arrange a new supplier.

I would now like to describe how our proposed projection of prices under controls would work and the actions we would take if prices exceeded an index price of the projections plus 2 cents per gallon.

Our index projections will be generated by taking into account the current level and projected increase in the cost of crude oil, the increased cost of doing business for refiners and marketers, and the seasonal price variations for middle distillates.

We will have our reporting system and method of projections developed and operational by the end of July this year as a result of an expedited rulemaking. We will, of course, begin immediately to collect data from available sources and do our preliminary computations so that we would have at least preliminary bench-mark values even before the end of July.

If at any time during the next heating season our data show that actual prices exceed the index price, i.e., the projected prices under controls plus 2 cents per gallon, we will hold public hearings within 10 days to determine the causes of such an increase and to solicit comments on various



actions necessary to restore average prices to levels at or below the index price within no more than one month.

As we discussed in our previous testimony, FEA will also establish a "set-aside" reserve of supply that would be used throughout the coming heating season for assignment to those few marketers who are temporarily unable to find a supplier after demonstrated good faith efforts to do so.

I hope these procedures will serve to assure the Congress that in the context of decontrol we will continue to fulfill our statutory responsibilities as Congress intended.



A third subject that I have included in this morning's testimony concerns crude oil prices. FEA is acting today to limit domestic crude oil prices to their June levels for a period of two months -- July and August. This action is being taken under authority of the crude oil pricing policy which is contained in the Energy Policy and Conservation Act. Although not directly related to the issue of the exemption from mandatory controls of middle distillate, this crude oil pricing action is relevant to the matters now under consideration by this Committee.

First, it underscores once again that domestic crude oil costs, the basic element in determining middle distillate prices, are under continuing controls as required by the EPCA. In a market characterized by abundant supply, competition will insure that the lower feedstock costs enjoyed by domestic refiners are most effectively passed on to the benefit of consumers.

Second, this action illustrates the ability of FEA to rapidly implement comprehensive data collection systems and to translate the information gained through such systems into regulatory actions that effectively carry out the intent of the Congress. I suspect that few people realize the magnitude and complexity of the regulatory effort that



has been necessary to carry out effectively the concept of the crude oil composite price limitations that were adopted by the EPCA. I am sure you can recall, however, that there was substantial doubt on the part of many members of the Congress as to whether the EPCA crude oil pricing provisions would be administratively feasible.

As a general background to the matters being considered by this Committee this morning, I would therefore like to outline the manner in which FEA has in good faith exercised its responsibilities in meeting the statutory requirements of the EPCA concerning domestic crude oil prices. The EPCA, enacted December 22, 1975, placed a limit of \$7.66 per barrel on the weighted average first sale price ("composite price") of domestic crude oil for the month of February, 1976, and provided for limited upward adjustments in the composite price in each of the following 39 months, in order to take into account the effects of inflation and as a production incentive.

Thus, in the period of December 22, 1975 through February 1, 1976, FEA was required to conduct a rulemaking proceeding and to adopt new crude oil pricing regulations intended to result in a composite price of \$7.66 per barrel in that month. FEA then conducted a second rulemaking proceeding to adopt regulations for price increases beginning



with March, 1976. Both rulemaking proceedings were conducted in the absence of any comprehensive information concerning first sale prices of domestic crude oil. Accordingly, FEA had to rely on certain estimates in devising the new regulations, while at the same time it undertook to develop a comprehensive data collection system for first sale prices of domestic crude oil.

The estimates relied on in formulating new crude oil pricing regulations were in all instances the same as those which had been furnished to the EPCA Conference Committee at the time it was evaluating the probable effects of the EPCA crude oil pricing policy. In brief, the principal estimates were that old (or "lower tier") crude oil amounted to approximately 60 percent of domestic production and sold for an average price of \$5.25 per barrel. The balance of domestic production could be sold for \$11.28 per barrel and a composite price of \$7.66 per barrel would result. FEA was careful to point out, however, that the percentage of lower tier production and the average lower tier price were closely interrelated, and that under a composite price limitation, if FEA's estimate of the percentage of lower tier crude oil production proved to be high, it might well be offset by the fact that its estimate of lower tier prices might also prove to be high.



This, in fact, proved to be the case. Actual data for February and March, 1976 (which are not yet final but are substantially accurate) show that the percentage of lower tier production is about 57 instead of 60; and that lower tier prices (before the March adjustment) were about \$5.07 per barrel.

Overall, the data on actual first sale prices of crude oil which have been collected through FEA's new comprehensive data collection system indicate that the actual prices charged under the new crude oil price regulations (which were necessarily formulated largely on the basis of estimates) were \$7.82 per barrel in February and \$7.80 per barrel in March -- \$.16 and \$.08 per barrel above the EPCA composite price limitations of \$7.66 and \$7.72 for those months. In light of the substantial number of estimates and variables that were involved in implementing the crude oil pricing provisions of the EPCA, I think these figures are remarkably close to the mark.

In order to minimize the extent of any further actual prices above the EPCA composite price limitation, and to provide time for collection and evaluation of further actual price data, FEA has temporarily discontinued the monthly adjustments in crude oil prices, and will hold prices at their June levels for the months of July and August.



This concludes my prepared statement. I would be pleased to answer any questions the members of the Subcommittee may have.

