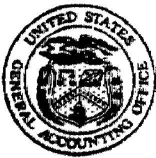

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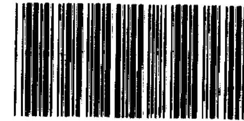
NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION

B-217506

FEBRUARY 5, 1985

The Honorable Mike Synar
Chairman, Subcommittee on Environment,
Energy, and Natural Resources
Committee on Government Operations
House of Representatives



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Dear Mr. Chairman:

Subject: Survey of Oil Company Views on Fair Sharing in an International Oil Supply Disruption (GAO/NSIAD-85-45)

As requested in your August 10, 1984, letter and subsequent discussions with your staff, we have surveyed U.S. oil companies that participate in the International Energy Agency (IEA) to determine their views on whether some form of a fair sharing program is needed in the United States to meet an IEA emergency oil sharing obligation.[1] Fair sharing refers to a domestic system to ensure that the burden of sharing oil to meet an IEA supply obligation is borne proportionately or fairly by all oil companies. In other words, among petroleum companies operating within an IEA country, no one company should be disproportionately penalized or benefited due to actions it takes to help the country meet its IEA supply obligation.

All IEA countries, except the United States, have established or are establishing fair sharing programs. These programs vary considerably but typically rest upon some form of domestic allocation system. However, the term fair sharing has been used by some U.S. oil companies to mean something other than domestic allocation, namely, guaranteed access to oil from the Strategic Petroleum Reserve (SPR).

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[1]IEA was established in 1974 to facilitate a coordinated response among the oil-consuming industrialized countries to oil supply disruptions and other energy problems. Its 21 member nations have, among other things, agreed to subject their oil supplies to an international allocation system in the event of a severe oil supply disruption, using a pre-determined complex formula to calculate each country's right to receive oil or obligation to provide oil.

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The most significant results of our survey were as follows. A majority of the companies see the need for the government to assume or be prepared to assume a role in assuring that voluntary oil sharing does not impose an unfair burden on participating companies. However, a majority of the companies surveyed do not support a domestic allocation system, as was recommended by a State Department consultant, for meeting the fair sharing objective. Some suggested that the use of SPR oil to replace volunteered oil would encourage companies to make voluntary offers.

Many of the companies surveyed indicated that one or more of the following factors have influenced their current views: (1) the growing size of the SPR and the administration's announced policy to "ordinarily" auction off large amounts of SPR oil at an early stage of a major supply interruption, (2) the administration's position to rely primarily on a market approach to determine the redistribution of energy supplies during an emergency, and (3) changes in how oil allocated among IEA countries during an emergency would be priced.

CURRENT OIL COMPANY VIEWS ON FAIR SHARING

We sent questionnaires to 17 U.S. oil companies that participate in IEA activities and are known as "Reporting Companies;"[2] 15 companies responded. These companies hold divergent views on fair sharing and the form it should take.

The responses showed that:

--7 companies (representing about 55 percent of total reporting companies' crude oil imports during a recent 6-month period and including 4 major U.S. oil companies[3]) indicated they would not or probably would not volunteer oil supplies to help meet U.S. international oil sharing obligations if a new government initiative (either an allocation system or guaranteed access to SPR

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[2]Oil companies invited by the IEA and approved by their respective governments to actively participate in IEA activities. They voluntarily agree to report to the IEA directly about their volume and flow of oil in an emergency.

[3]For the purpose of this study we defined a company as a "major" if it was among the top 7 U.S. reporting companies in terms of crude oil inputs to refineries during a recent 6-month period. The 7 majors accounted for nearly three-quarters of U.S. reporting companies' inputs to refineries.

oil) was not in place. Six companies (representing about 35 percent of the imports and including 3 majors) said they would or probably would make offers. One was undecided and one said it would probably not provide oil regardless of the circumstances.[4]

--8 companies (including 4 majors) favored some form of government fair sharing program (4 wanted domestic oil allocation and 4 proposed guaranteed access to SPR oil) when the IEA's emergency oil sharing system is triggered. The 7 other companies said that establishing a fair sharing program was not or probably was not needed, but 4 of them suggested that the government be prepared to subsequently use SPR oil to compensate companies if the free market approach proved to be inadequate.

--11 of the 15 companies (representing a large majority of reporting companies' crude oil imports) opposed a domestic oil allocation program.

--12 of the 15 companies (representing about 80 percent of total reporting companies' crude oil imports) indicated the need for the government to assume or be prepared to assume under at least some circumstances a role in assuring an equitable sharing of the burden of providing oil to meet U.S. commitments to the IEA. (As shown above, 8 of the 12 preferred some form of fair sharing program when the IEA system is triggered and 4 felt the government should be prepared to respond if the market approach fails.) The remaining 3 companies said that the free market approach combined with the current SPR drawdown plan alleviated the necessity for any further government efforts.

--8 of the 15 companies, accounting for about 75 percent of reporting companies' total crude oil

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[4]Many of the companies qualified their responses. For example, a few companies which said they would not make offers indicated they might do so if their customers would not be hurt. Several companies which said they probably would make offers indicated they would not do so if they lacked excess oil supplies or if their supplies were severely disrupted.

imports and including 6 of 7 major U.S. oil companies, recommended the government use or be prepared to use SPR oil to help companies meet U.S. supply obligations under the IEA system. (Four said SPR oil should or could be used to guarantee replacement oil to companies making voluntary offers, 3 suggested the SPR be used to compensate companies if the free market approach did not generate sufficient voluntary offers, and 1 company said that if the government found it necessary to issue mandatory supply orders, the companies issued such orders should be guaranteed SPR replacement oil.)

OBJECTIVES, SCOPE AND METHODOLOGY

You asked that we survey U.S. oil companies to determine whether they (1) would volunteer oil in a crisis if a fair sharing system were not in place, (2) believe fair sharing is necessary to make the IEA system work, (3) feel fair sharing should be in the form of a domestic allocation program, as recommended in a study by a consultant to the State Department (see p. 2 of enclosure), (4) support the Department of Energy's position that with current U.S. policies fair sharing is not needed, or (5) would suggest some alternative.

To elicit the requested information, we developed a questionnaire that included both structured and open-ended questions and asked 17 U.S. reporting companies[5] to respond. During a major international oil supply disruption they would be generally better positioned than other U.S. oil companies to divert oil to other IEA countries in a timely and cost effective manner because of their heavy involvement in the international oil trade. During a recent 6-month period, for which information was readily available, these companies accounted for about 70 percent of U.S. crude oil imports.

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[5]There are 19 U.S. reporting companies. However, one company has no domestic oil operations and for that reason was not included in our survey. Another company was involved in a merger, and said that its views were represented by the company with which it was being merged. The 17 companies surveyed were: Amerada Hess Corp.; ARCO Petroleum Products Co.; Ashland Oil, Inc.; Champlin Petroleum Co.; Chevron U.S.A., Inc.; Conoco, Inc.; Exxon International Co.; Mobil Oil Corp.; Murphy Oil U.S.A.; Occidental Petroleum Corp.; Phillips Petroleum Co.; Shell Oil Co.; Standard Oil Co. of Indiana; Standard Oil Co. of Ohio; Sun Co.; Texaco, Inc.; and Union Oil Co. of California.

To increase the likelihood of securing candid responses, we informed the companies that only aggregate results would be presented, and individual companies would not be identified with their specific views.

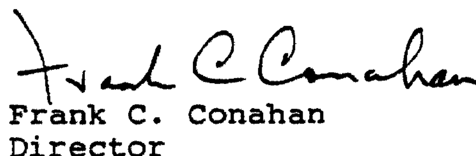
Since 15 of the 17 reporting companies responded, we believe the survey results are representative. The 15 respondents together accounted for about 95 percent of the 17 companies' crude oil imports. Six of the 15 respondents chose not to fill in the questionnaire, but instead provided statements of their views on fair sharing. By analyzing these statements, we were able to categorize their positions with respect to many of the survey questions and to aggregate the responses with those companies that did fill out the questionnaires. However, it was not possible to break down the statements to the degree of detail asked in the questionnaire's structured questions, so we have not included responses to the detailed questions.

Enclosure I provides background information pertinent to your request and discusses the factors influencing oil company attitudes toward fair sharing.

In preparing this report we used documents and records obtained from the IEA and the U.S. government and previous GAO reports on the IEA. (See enc. II.) The purpose of the survey was to obtain oil company views. At your request we did not seek agency comments on this report.

No further distribution of this report will be made for 30 days from the date of issue unless you authorize its release or publicly announce its contents earlier. At that time we will send copies to the Secretaries of Energy and State and to other cognizant congressional committees and interested parties.

Sincerely yours,



Frank C. Conahan
Director

Enclosures - 2

BACKGROUND ON FAIR SHARING AND FACTORS INFLUENCING OIL COMPANY ATTITUDES

The 21 member nations[1] of the IEA have, among other things, agreed to subject their oil supplies to an international allocation system during a severe emergency; a predetermined, complex formula will be used to calculate each country's right to receive oil or obligation to provide it. Under this system most oil supply redistribution is expected to be achieved by (1) actions taken by the oil industry as part of its normal commercial conduct and/or (2) transactions resulting from the matching by the IEA Secretariat in Paris of oil company voluntary offers to share oil with requests to receive oil. If these activities are not sufficient to meet a country's obligation to share oil, a government can issue mandatory supply orders to oil companies to ship oil to countries with receiving rights.

To increase the likelihood that member nations can satisfy allocation obligations without having to issue mandatory supply orders, the IEA has long held that member countries should establish domestic fair sharing systems. Such a system would assure that the burden of sharing oil by a country which has an allocation obligation is borne proportionately by all companies within the country by reallocating oil supplies among companies. This view is consistent with that adopted by the international oil companies when the IEA was created. Most companies indicated they would not volunteer oil supplies unless they were assured that the burden would be fairly shared with their domestic competitors.[2]

Fair sharing is one of the IEA objectives in implementing international oil allocation but, out of recognition of differences among member countries with respect to antitrust laws and competition, the IEA has placed responsibility for fair sharing on member country governments. All IEA countries, except the United States, have established or are establishing programs for

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[1]Australia, Austria, Belgium, Canada, Denmark, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States, and West Germany. For additional information on the origin, development, and operation of the IEA, see the sources listed in enclosure II.

[2]U.S. General Accounting Office, Assessment of U.S. Participation in the International Energy Agency's Fourth Test of Its Emergency Sharing Allocation System (GAO/NSIAD-84-4, Oct. 13, 1983).

fair sharing of their respective national oil supplies during an emergency. These programs vary considerably across the countries, but typically rest upon some kind of allocation system.

When the United States joined the IEA in 1974, fair sharing within the United States was to be carried out as part of the broader domestic crude oil allocation system then in place. However, in 1981 the United States abolished its oil allocation and price controls, and in so doing eliminated the existing mechanism for achieving fair sharing during emergencies. The elimination of oil price and allocation controls was generally well received by the U.S. oil industry, but the industry said that a limited standby program for emergency oil distribution should be available for use in severe emergencies. Industry officials said this was necessary if companies are to be encouraged to make voluntary international reallocation offers of their oil.[3]

In July 1981 the Department of Energy (DOE) informed the Congress that it planned to develop a contingency plan for a limited crude oil fair sharing system for activation during emergencies, as a backstop to voluntary offers should the President deem it necessary to meet U.S. supply obligations to the IEA. However, such a system was not developed.

A 1983 test of IEA's emergency allocation system, known as AST-4, indicated that many U.S. oil companies still felt a fair sharing system was needed. In fact, 10 of the 14 U.S. reporting companies that made voluntary offers during the test told Department of Energy officials well before the test that fair sharing would be necessary to induce them to make voluntary offers through the IEA system and/or specifically assumed during the test that a fair sharing system was in place. The combined offers of these companies accounted for 88 percent of net reporting companies' voluntary offers. Following its post-test assessments, the IEA expressed concerns about whether the absence of a fair sharing program in the United States would adversely affect company voluntary offers and the operation of the IEA emergency system.

A consultant's study prepared in late 1983 for the Department of State examined the fair sharing issue. After obtaining the views of a number of major U.S. companies, small and large

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[3]National Petroleum Council, Emergency Preparedness for Interruption of Petroleum Imports Into the United States (Apr. 1981), pp. 7, 10, 12, and 232. This Council is a federal advisory committee appointed by the Secretary of Energy and represents all segments of the petroleum industry.

independents, and refiners and resellers, the consultant concluded that a fair sharing program must be developed to ensure a timely response by the oil companies and to keep pressure on the world oil markets to a minimum in an emergency. The consultant assessed several alternatives and concluded that the best approach was a fair sharing allocation system based on the participation of all U.S. oil refiners.

In early 1984, following a re-examination of the fair sharing issue, the Secretary of Energy informed the Congress that a fair sharing program was not needed. In the event the United States does incur an allocation obligation, the Secretary believes sufficient voluntary offers will be forthcoming from the oil companies for the following reasons. When the government draws down SPR oil, companies can seek to replace their voluntary offers through the auction process by bidding on the SPR oil. Companies can also seek replacement oil in the open market at spot prices, and can charge spot prices for their voluntary offers. The government will strongly encourage the companies to make voluntary offers. Finally, companies must contend with the possibility that the government may issue mandatory supply orders to specific companies if sufficient voluntary offers are not made. He believes that the companies would prefer making voluntary offers to government intervention.

INFLUENCES ON COMPANY VIEWS

Many of the companies responding to our survey indicated that one or more of the following factors have influenced their current views: (1) the growing size of the SPR and the government's February 1984 decision to "ordinarily" draw down SPR oil early and in large amounts in a severe emergency, (2) the U.S. position to rely primarily on market forces in an emergency, and (3) the December 1983 IEA decision concerning the pricing of oil to be shared internationally.

SPR drawdown

Until recently, the SPR was not particularly useful for an energy disruption because of its limited size. The SPR now holds about 450 million barrels of oil. It represents more than 90 days of U.S. crude oil imports and is an important tool which can be used in any serious oil supply disruption.

Through 1983 the U.S. position was perceived to be that the SPR would be used as a last resort. Early in 1984, however, U.S. officials advised the other IEA members that the United States "ordinarily" intends to draw down the SPR in large amounts at an early stage of a major supply interruption.

The U.S. position is best summarized in testimony given by the Secretary of Energy on February 21, 1984, before the Subcommittee on Fossil and Synthetic Fuels, House Committee on Energy and Commerce:

> ". . . in a major disruption, the early sale of SPR oil in large volumes ordinarily is the best policy for SPR use. This policy makes it possible to replace rapidly some oil lost because of a disruption and, therefore, to reduce price increases while worldwide supply and demand reach equilibrium. The marketplace needs to know in advance that this is our general policy so that unnecessary panic behavior can be avoided. . . The SPR . . . is an operational tool, and I have no hesitancy in declaring our willingness and intention ordinarily to use it to optimum advantage early in a serious oil supply interruption."

Some companies felt this policy was generally sufficient to assure that those companies which make voluntary offers will not be unduly disadvantaged in relation to their domestic competitors. Others disagreed, pointing out that the auction process does not guarantee that those companies which make voluntary offers will necessarily succeed in the auction. They said that assured access is critical, since it would not be fair to cut off their domestic customers when other companies are not doing the same, and that they could not afford to sacrifice their domestic markets. They noted that a quick response by companies is important to the success of the IEA's emergency sharing system and that such responses will be delayed if companies have to wait to see how they do in an SPR auction.

Some companies which favor assured access indicated that they do not necessarily mean that each barrel of oil which they voluntarily offered to another IEA country should be replaced by a barrel of SPR oil. As one company said, the government needs to be aware of how the disruption affects various companies making voluntary offers; any company requesting that its voluntary offer(s) be directly offset by access to SPR oil should have to demonstrate that it has a real need.

Reliance on market forces

Central to the administration's energy supply policy for supply emergencies is a commitment to rely principally on a market approach, accompanied with the use of the SPR, to determine the price and allocation of supply. This energy policy, according to DOE, is part of an overall economic policy that calls for less federal intervention. Elements of the U.S. policy are to

preclude regulatory measures and rely on the marketplace, with realistic pricing signals to obtain efficient and effective energy production, distribution, and conservation. According to the Department of Energy, this policy recognizes the key role of the private sector in energy decisions and imposes limits on the government's role. Under this approach the emphasis will be on market allocations even during a supply disruption.

The majority of responding companies commented that the administration's strategy had influenced their views. Four companies said they welcome reliance on market forces but believe something additional is needed such as guaranteed access to SPR oil. Four said the market approach should be tried first but the government should be ready to use SPR oil if the market approach does not generate sufficient voluntary offers. Three said they support the market approach and did not suggest a need for anything else.

Pricing of allocated oil

The price of oil shared in an international emergency is important to the effective distribution of oil supplies among consuming nations. For many years, lack of clarity about how to price oil allocated from a company in one IEA country to a company in another member country has raised questions about the viability of the IEA's emergency sharing system in a real disruption. A recent IEA decision has helped to clarify this question but has not necessarily fully resolved it.

According to the 1974 Agreement establishing the IEA, the price of allocated oil shall be based on price conditions prevailing for comparable commercial transactions. However, until recently the IEA Emergency Management Manual provided for oil to be allocated at term and not spot prices.[4] This concerned many U.S. oil companies, which believe that most oil traded in an emergency will be at high spot market prices. The language of the Emergency Management Manual indicated that oil companies should sell shared oil at prices less than spot prices; in the view of many companies, this was not realistic.

The U.S. government believed that restricting allocated oil prices in an emergency to term prices would be inconsistent with the IEA agreement and U.S. energy policy. However, some other member governments viewed the pricing issue differently, opposing

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[4]Spot prices refer to the price of oil which is not under contract and which can fluctuate on a daily basis; term prices refer to contractual prices that generally remain constant for a longer duration.

the use of spot pricing in an actual emergency on the grounds that such pricing substantially raises crude oil prices. They supported the use of term pricing.

This issue has been long debated within the IEA; however in December 1983, the IEA Governing Board decided to amend the Emergency Management Manual language. The principle that term and not spot prices should be used was dropped and replaced by the principle that the price for allocated oil should be based on price conditions prevailing for comparable commercial transactions and that comparable transactions do not exclude any types of market transactions.

On the basis of this decision, allocated oil can be priced at any level, ranging from as low as pre-disruption contract prices that continue in effect through part or all of the disruption to peak spot market prices at the height of the disruption.

Oil companies we surveyed generally indicated that the price they receive for oil diverted to other IEA countries in an energy emergency is a major concern. Twelve companies indicated that the price should be based on the prevailing market price at the time of diversion. In fact, getting the market price for their diverted oil was viewed by some as necessary to make their voluntary offers. Three companies said they believe the IEA decision to base voluntary offer transactions on market prices resolved the long-running pricing issue for diverted oil. One company, however, believed the decision did not ensure that spot pricing will be accepted as the basis for transactions. The company said there definitely is a difference of opinion about what the words "comparable commercial terms" mean, as agreed to by the IEA in December 1983. The company added that the language agreed upon was a compromise which papered over differences of views on what prices should prevail.

That company also expressed concern about how other IEA countries, with IEA supply rights, would interpret the decision. The company said that just making voluntary offers does not solve the problem. Companies may not complete the voluntary transaction if the government of a country with supply rights refuses to allow imports of oil at prices higher than some administratively set level.

Another company expressed the belief that, even if oil is selling at spot prices, it is not clear that adequate quantities of oil will be available to meet demand. The company believed that during a supply crisis the spot market may dry up temporarily until the market realizes what the real value of oil is. This company and others said they wanted some sort of access to SPR oil, if needed.

LIST OF UNCLASSIFIED GAO REPORTS DEALING WITH THE INTERNATIONAL ENERGY AGENCY

--Assessment of U.S. Participation in the International Energy Agency's Fourth Test of Its Emergency Sharing Allocation System (GAO/NSIAD-84-4) October 13, 1983.

--Oil Supply Disruptions: Their Price and Economic Effects (GAO/RCED-83-135) May 20, 1983.

--Information on the Operation of the International Energy Agency's Coal Industry Advisory Board (GAO/ID-83-44) April 21, 1983.

--Analysis of Department of Justice Memorandum Concerning President's Statutory Authorities in Oil Crises (GAO/OGC-83-6) March 4, 1983.

--Analysis of the Comprehensive Energy Emergency Response Procedures Report (GAO/RCED-83-106) February 17, 1983.

--Determination of Oil Price in the International Emergency Sharing System--An Unresolved Issue (GAO/ID-83-15) November 12, 1982.

--The Changing Structure of the International Oil Market (GAO/ID-82-11) August 11, 1982.

--Demand Restraint and Fair-Sharing Under the International Energy Program (B-206525) April 6, 1982.

--The United States Remains Unprepared for Oil Import Disruptions (Two Volumes) (EMD-81-117) September 29, 1981.

--Unresolved Issues Remain Concerning U.S. Participation in the International Energy Agency (ID-81-38) September 8, 1981.

--Analysis of the Energy and Economic Effects of the Iranian Oil Shortfall (EMD-79-38) March 5, 1979.

--U.S. Energy Conservation Could Benefit From Experiences of Other Countries (ID-78-4) January 10, 1978.

--U.S. Oil Companies' Involvement in the International Energy Program (HRD-77-154) October 21, 1977.

--Issues Related to Foreign Sources of Oil for the United States (B-179411) January 23, 1974.