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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY  
Expected at 9:30 a.m.  
Monday, February 26, 1979

STATEMENT OF  
J. DEXTER PEACH  
DIRECTOR, ENERGY AND MINERALS DIVISION;  
BEFORE THE  
SUBCOMMITTEE ON ENERGY AND POWER  
OF THE  
HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE  
ON  
[ THE STRATEGIC PETROLEUM RESERVE ]

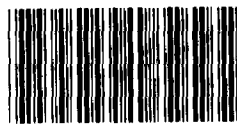
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Mr. Chairman and Members of the Subcommittee:

We welcome the opportunity to be here to discuss GAO's work still in process on the size of the strategic petroleum reserve and three aspects of the Department of Energy's (DOE's) management of the reserve. Although our work in both areas is still underway, we expect to issue reports sometime in March.

SIZE OF THE RESERVE

The 1973-74 Arab oil embargo demonstrated U.S. vulnerability to interruptions in petroleum supplies and increased national concern for reducing the effects of potential future import interruptions. In December 1975, the Energy Policy and Conservation Act was enacted authorizing the creation of a reserve of up to 1 billion barrels of crude oil and petroleum products.



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*Testimony*

In December 1976 DOE, as required by the act, submitted a reserve plan which was approved by the Congress, calling for a 500 million barrel reserve by 1982. In support of this amount, the plan projected potential U.S. oil supply shortfalls due to political embargoes, cited economic and foreign policy justifications for the reserve, and described development plans.

Later, in June 1978, DOE amended the plan with congressional approval. The amendment called for a 1 billion barrel reserve by 1985. The increase in size was supported by projections of U.S. oil supply shortfalls due to interruptions caused by military actions as well as the previous political embargo scenarios. It also cited national security reasons in addition to the economic and foreign policy reasons supporting the 500 million barrel reserve and set forth development plans for the first 750 million barrels.

Data supporting  
the size

The original December 1976 reserve plan used two political embargo scenarios lasting for 6 and 9 months to justify a 500 million barrel reserve by 1982. One scenario assumed a 25 percent production cut by the Organization of Arab Petroleum Exporting Countries (OAPEC) and no shipments to the United States. This scenario is similar in magnitude to the peak of the 1973-74 embargo initiated by OAPEC. The other scenario assumed a 50 percent OAPEC production cut, which, according to DOE, would most

likely result from another Middle East war. The highest estimated 1985 U.S. shortfall, based on these two scenarios, was 2.7 and 4.6 million barrels per day, respectively.

The June 1978 amendment to increase the reserve to 1 billion barrels included these two scenarios plus a third--a 100 percent loss of all petroleum exports from the Persian Gulf for 3 and 6 months. The highest estimates of U.S. shortfalls in the amendment were much higher--3.9, 7.7, and 10.9 million barrels per day, respectively, for the three scenarios.

In January 1979, DOE's Energy Information Administration issued a report, "Petroleum Supply Vulnerability, 1985" which again revised the estimates of U.S. oil supply shortfalls. This report used a wide range of assumptions underlying the three scenarios which resulted in shortfalls ranging from 2.6 to 8.5 million barrels per day. As a DOE official pointed out, the study's shortfalls can be used to support a wide range of reserve sizes.

In addition to projecting supply shortfalls, DOE has prepared various other studies and papers addressing the reserve size issue.

Determining the optimum reserve size is extremely difficult because of the many unknowns, assumptions, variables, and political factors which must be considered, and because there is no realistic way to assign quantitative probabilities to possible supply disruptions. As far as we could determine, no study has been completed that concludes 1 billion barrels

is the optimum size. The numerous studies we examined use many different approaches and assumptions, contain a wide range of estimated shortfalls but reach no consensus on the appropriate reserve size.

Stated another way, even after considerable analysis is completed, an informed but subjective judgment must be made about the size of reserves required.

Alternatives to help meet  
oil supply disruptions

There are other options which could help the United States avoid relying mainly on a federally owned reserve to meet future shortfalls during an oil supply disruption. We have identified three:

- demand restraint and supply management,
- an industrial petroleum reserve, and
- existing industry reserves.

Demand restraint and  
supply management

We reported in a February 13, 1979, letter to you and Chairmen of other energy-related Committees and Subcommittees our concern over DOE's failure to develop and submit to the Congress a package of emergency energy conservation plans and a gasoline rationing plan. Without such plans, and without a clear understanding of how effectively they would restrain demand and allocate available supplies, it is extremely difficult to evaluate the reserve size needed to prevent a serious

disruption resulting from a petroleum supply shortfall. Our latest information is that DOE intends to submit four emergency energy conservation plans and a gasoline rationing plan to the Congress today for its approval.

In a broader context, a strong, coordinated national energy conservation program could go a long way toward minimizing the adverse impacts of a crude oil supply disruption. Our February 13 letter summarized the results of 2 or 3 years of work in the energy conservation area and discussed the following three overriding problems which, in our opinion, have limited the success of the Nation's efforts to conserve energy:

- A lack of specific planning and direction from the Government in the energy conservation area.
- The absence of an aggressive, coordinated effort by the Government to conserve energy in its operations and facilities.
- The failure to develop, and have approved by the Congress, emergency energy conservation and gasoline rationing plans.

In our view, these problems must be addressed and corrective action taken if the Nation is to move forward with an effective overall energy conservation program.

#### An industrial petroleum reserve

The Energy Policy and Conservation Act authorized (but did not require) the creation of an industrial petroleum reserve by directing petroleum refiners and importers to store in readily available inventories up to 3 percent of

the amount they refined or imported during the previous year. This inventory, which is in addition to normal industry inventories, would be part of the strategic reserve. The 3 percent maximum industrial reserve would amount to about 185 million barrels based on 1977 consumption levels. DOE evaluated numerous advantages and disadvantages of this option, and decided that an industrial reserve should not be established. A summary of DOE's evaluation is attached to my statement.

#### Existing industry reserves

Present industry oil inventories available to help offset a supply disruption are unknown. The United States reported industry oil stocks equivalent to 131 days of oil imports to meet its International Energy Program (IEP) emergency reserve commitment in July 1978. However, the actual availability of these stocks to meet an emergency supply shortfall is unclear. Most of these stocks are working inventories required to maintain normal operations and could not be withdrawn without disrupting the oil industry's logistical system. DOE has questioned the availability of existing industry stocks and is not presently relying upon them. However, several studies, including one by the National Petroleum Council, indicate that the oil industry and major consumers have some stocks available above the minimum levels necessary to continue normal operations.

#### International emergency oil sharing

One of the objectives cited in the legislation for creating

the reserve was to fulfill U.S. obligations under the IEP. However, the United States meets its IEP emergency reserve commitment solely by reporting oil industry stocks. DOE officials stressed that the reserve is a domestic program and does not increase U.S. oil sharing obligations of reserve commitments under IEP. However, as a State Department official explained to us, a large reserve could become a buffer in the event of a large supply disruption. The U.S. could draw upon the reserve and give up allocated supplies to meet the needs of its allies.

The official U.S. Government position is that the IEP oil sharing system will work. Under this veneer of confidence, however, our discussions with DOE and State Department officials revealed doubt and concern about what would happen in the event of a severe or extended supply disruption. This doubt was based upon

- a questionable definition of emergency reserves which causes overstatement of available stocks,
- the absence of a mechanism to settle price disputes among oil companies facing potential economic losses in allocating oil from countries with higher prices to countries with fixed prices, and
- insufficient authority to require international oil companies to reallocate supplies among the United States and other IEP nations.

A January 1979 DOE projection illustrates the potential magnitude of U.S. obligations under the IEP. Under a scenario assuming a loss of 50 percent of supplies from the Persian Gulf, nearly 20 percent of the highest U.S. crude oil shortfall or 1.1 million of the total shortfall of 5.8 million barrels of oil per day, could result from U.S. obligations under the IEP.

Emergency petroleum reserve programs in other countries

Nearly all of the world's industrialized, import-dependent countries have established mandatory emergency petroleum reserve programs. The reserves each country will have to meet supply shortfalls differ substantially, depending on the countries' size requirements, method of ownership and control, and storage procedures.

The absence of mandatory industry involvement in the U.S. program distinguishes it from emergency reserve programs of other IEP countries. Moreover, the planned level of segregated, Government-owned stocks in the U.S. strategic reserve will make it by far the largest Government-owned program. Despite their relatively greater dependence on imported oil, only 5 of the 19 IEP countries are establishing segregated, Government-owned reserves in addition to their industry reserves. Furthermore, their relatively small sizes, which will range from 5 to 24 days of net oil imports, based on 1977 import levels, are dwarfed by the U.S. Government's planned 116-day reserve at 1977 import levels.



We found that the reserve experience of Germany and Japan was most relevant to the United States. Germany requires its oil industry to maintain reserves equal to 25 to 90 days of imports, plans to establish a government-owned reserve equal to about 24 days of oil imports by 1980, and recommends that large oil consumers maintain reserves equal to 14 days of consumption. Japan requires its oil industry to maintain reserves equal to 90 days of imports, and plans to establish a 20 day government-owned reserve by 1985.

SUMMARY OF MAJOR GAO OBSERVATIONS  
AND CONCLUSIONS

To summarize, to date our review has raised several questions concerning the size of the reserve. Tentative GAO observations and conclusions which the Congress may wish to consider are:

- No study has shown that 1 billion barrels is the optimum-size reserve.
- Recent analysis by DOE indicates that the largest potential supply shortfalls, 6.6 and 8.5 million barrels per day, under selected disruption scenarios are considerably less than the largest projection of 10.9 million barrels per day made at the time the amended plan was prepared.
- The 1 billion barrel reserve is sized to meet a supply disruption of far greater magnitude than ever experienced in the past.

--A 1 billion barrel reserve is disproportionately larger and more costly than that of any other nation. Other programs or options could be used in conjunction with a federally funded reserve to reduce vulnerability. For example,

--more can and should be done to restrain demand and manage supply,

--a mandatory industrial petroleum reserve, as provided for in the legislation, could be adopted, and

--existing industry inventories may provide some help.

We understand that DOE and the Office of Management and Budget are reevaluating the size of the reserve. Because of the preliminary stage of their deliberations, we were not able to review any of their recent internal work. However, the Subcommittee may wish to explore this matter with the agencies.

#### DOE'S MANAGEMENT OF THE RESERVE

Aside from questions about the reserve's size, we have, as you are aware, Mr. Chairman, been evaluating various aspects of its management. In our January 9, 1978, and August 14, 1978, reports 1/ we criticized management decisions related to the acquisition and testing of storage facilities.

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1/"Questionable Suitability of Certain Salt Caverns and Mines for the Strategic Petroleum Reserve" (EMD-78-65, Aug. 14, 1978) and "Need to Minimize Risks of Using Salt Caverns for the Strategic Petroleum Reserve" (EMD-78-25, Jan. 9, 1978).

In our current review we have focused on three other aspects of DOE's management: (1) oil withdrawal capability, (2) contingency plans for transferring oil in a non-embargo emergency, and (3) site-specific security implementation plans. We expect to report to the Secretary of Energy on our review in the next few weeks. However, our tentative conclusions are that:

--None of the three existing storage sites have permanent oil withdrawal capability.

--Contingency plans for transferring oil in the event of a non-embargo emergency situation such as the West Hackberry fire have not been developed.

--DOE has not developed a site-specific security plan for each existing storage location to protect the site equipment and oil reserves from potential threats such as vandalism, theft, and terrorism.

#### Withdrawal capability

Although DOE had about 74 million barrels of oil in storage in mid-February 1978, oil withdrawal facilities are not scheduled to be installed at the present storage sites until the summer or fall of this year.

DOE officials contended that they have not ignored the need for oil withdrawal capability. DOE stated that priority has been given to obtaining and storing the crude oil as quickly as possible in view of the increasing cost of oil. Also, they point to the environmental permit approval

process as causing delays in the construction of permanent withdrawal equipment.

DOE is continuing to give priority to putting oil in the ground before oil withdrawal capability will be completed. For example, DOE estimates oil fill at Weeks Island, a site which will not require a permit to install withdrawal capability, will begin in September 1979. Withdrawal capability is not scheduled until March 1980.

Without withdrawal capability, the reserve would be ineffective in helping to deal with the very situation for which it was created--an oil embargo. Therefore, the question at hand is whether or not withdrawal facilities should be installed at future sites before oil fill begins.

#### Need for contingency plans

Concerning oil that could be released during a non-embargo emergency, such as the fire at the West Hackberry storage site last September, we noted that DOE had no contingency plans for transferring or storing the oil that was released at the time of that fire.

During the fire, DOE was able to recover most of the estimated 30,000 barrels of oil that did not burn only because of the availability of storage equipment, the cooperation of barge owners and other support industries, and the comparatively small volume of oil involved.

As more oil is stored in the ground, it becomes doubtful that these measures will prove adequate. We believe that DOE should have plans for dealing with such non-embargo contingencies.

Need for security plans

As to the question of security at the storage sites, we visited the three existing storage sites and observed that some security measures had been taken. For example, guards were posted at the entrances, and some lighting and fencing were installed. However, we found that DOE has not determined the specific security needs for each storage site.

According to a 1978 Sandia Laboratories study 1/ and petroleum industry representatives, the most common security threats are tool and equipment theft during construction and, to a lesser extent, minor sabotage. In addition, the Sandia study stated that the reserve's high visibility of the SPR program during an embargo could make it an attractive target for terrorist activity.

We believe that both the equipment and the oil must have adequate site-specific security, and that DOE should develop and implement a security plan at each of the three sites.

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In summary, Mr. Chairman, we have raised questions concerning the size and management of the strategic petroleum

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1/"Security for the Strategic Petroleum Reserve" (SAND 78-0769, Sandia Laboratories, 1978.)

reserve.

In addition, we have had continuing dialogue with DOE concerning the desirability of purchasing for the reserve, oil produced from the Outer Continental Shelf and onshore Federal leases on which royalties are paid. We continue to believe DOE should purchase all suitable royalty oil for the reserve. We estimate savings of \$400 million during the 1980-1985 timeframe if this option were implemented. The Subcommittee may wish to pursue this matter and, accordingly, we have included as attachments copies of our October 6, 1978, letter report and DOE's December 19, 1978, response.

That concludes my written statement, Mr. Chairman. We would be happy to respond to questions.

Summary of  
Advantages and Disadvantages of the IPR

Advantages

- Federal expenditures for the SPR would be reduced.
- Industry would be able to use existing storage capacity for some of the stocks.
- The reserve would include some finished products.
- Some of the objectives of regional storage would be achieved.
- Logistical requirements and distribution problems would be reduced.
- A conservation benefit would result to the extent costs are passed on to consumers.
- Additional reporting requirements would provide more detailed information on industry inventories.

Disadvantages

- One industry alone would be forced to bear a share of the SPR costs.
- Large amounts of industry capital would be diverted from other, more productive investments.
- Most firms would have difficulty recovering the cost of implementing an IPR in a competitive marketplace.
- The differing structures of various companies would result in unequal abilities to bear IPR costs and lead to competitive distortions.
- Firms would seek exemptions or exceptions from an IPR requirement or use litigation to delay compliance.
- Another regulatory staff would be required, and additional funding would be necessary to deal with compliance, exceptions, and appeals.



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

ENERGY AND MINERALS  
DIVISION

OCT 6 1978

B-178205

The Honorable  
The Secretary of Energy

Dear Mr. Secretary:

Our Office has studied and reported on various aspects of the oil purchase policy being followed for the strategic petroleum reserve (reserve). In February 1977 we issued a report <sup>1/</sup> to the Congress which stated that oil produced from Outer Continental Shelf and onshore Federal leases--on which royalties are paid--could be purchased for the reserve at substantial savings to the Government. The Federal Energy Administration, which was responsible at that time for developing the reserve, considered buying royalty oil for storage but concluded that it would adversely impact financially on small refiners that relied on royalty oil.

In a July 6, 1978, letter to the head of your Office of Strategic Petroleum Reserve, we asked for comments on the potential savings available if the Government purchased the royalty oil that is not sold to small refiners. The response of July 24, 1978, was that the difficulties of purchasing royalty oil for the reserve outweighed the potential savings. We would like, in this letter, to elaborate on this issue because we believe that the savings are very significant even in view of the difficulties that they may entail.

BACKGROUND

To diminish U.S. vulnerability to the effects of a severe interruption in energy supplies, the Energy Policy and Conservation Act (Public Law 94-163) required the creation of a strategic petroleum reserve. In December 1976 the Federal Energy

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<sup>1/</sup>"Issues Needing Attention In Developing The Strategic Petroleum Reserve," EMD-77-20, February 16, 1977.

EMD-79-1  
(990593)



Administration submitted to the Congress a plan which stated that the reserve would contain 500 million barrels of oil by December 1982. The Department of Energy accelerated the reserve schedule by 2 years and undertook to store 500 million barrels of oil by the end of 1980. The Department now plans to store 1 billion barrels by the end of 1985. While the Department has not yet estimated the cost to store 1 billion barrels, it has estimated the cost to store 750 million barrels at \$14.4 billion.

Oil for the reserve will be stored in salt caverns and in mines. Thus far, the Department has acquired four storage sites in Texas and Louisiana near the Gulf Coast.

The Department is required by the Energy Policy and Conservation Act to acquire crude oil for the reserve in a way which minimizes cost. The act also authorizes purchase of royalty oil for the reserve. But the Department's plan is to acquire, through its entitlements program <sup>1</sup>/, all crude oil needed for the reserve on the open market at a price near the national average composite price.

#### THE POTENTIAL SAVINGS

The Department of the Interior collects royalties, in money and in kind, i.e., as oil and natural gas, from oil produced on leased Federal onshore lands and from the Outer Continental Shelf. Interior has been selling all of the royalty oil taken in kind to small refiners. According to Interior, in calendar year 1977 royalty oil production was 69.2 million barrels of which 40.4 million barrels or 58.4 percent was taken by the Federal Government and sold to small refiners. The Federal Government received cash for the remaining 28.8 million barrels or 41.6 percent. Interior expects very little change in these relative percentages in the near future.

Department officials calculated that based on May 1978 crude oil prices, royalty oil would be \$3.01 a barrel less than the national average composite price. Total savings that could result from buying royalty oil for the reserve

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<sup>1</sup>/Entitlements permit refiners to share the benefits associated with access to price controlled crude oil. The Department issues each refiner enough entitlements to permit it to process the national average ratio of price controlled oil to total crude oil purchased. In purchasing crude oil for the reserve, the Department considers itself a refiner.

could be very significant, especially if current price differences and price controls remain. For example, in our July 1978 letter, we calculated that 24 million barrels of royalty oil would not be sold to small refiners in the August 1978-July 1979 time frame. This amount could be acquired for the reserve at a \$72 million savings to the Federal Government. Because DOE plans to purchase oil for the reserve through 1985, additional savings of over \$400 million 1/ could be possible.

#### THE PERCEIVED PROBLEMS

In its July 24 letter to us, the Office of Strategic Petroleum Reserve listed the following three problems associated with purchasing royalty oil.

- Purchasing royalty oil would result in additional administrative burden to the Federal Government.
- Some royalty oil is not suitable for reserve storage.
- Purchasing royalty oil would result in the Department having to pass on some of the cost of the reserve to oil users rather than taxpayers.

#### Additional administrative burden

The Office of Strategic Petroleum Reserve letter states that additional administrative burden would result from handling numerous leases and transportation arrangements, and from arranging agreements whereby the royalty oil that is not suitable for storage would be exchanged for suitable oil. A Department official, however, told us that no attempt to quantify the additional burden had been made. This official stated that royalty oil production involved over 13,500 leases, which suggests to the Department a large quantity of administrative work.

We then asked Interior officials who administer the royalty oil program if they could estimate the additional administrative burden which would result if the royalty oil not sold to small refiners were acquired for the reserve. They

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1/This figure is based on the assumption that there will be approximate annual savings of \$72 million during the 1980-1985 time frame.

estimated the administrative cost to be \$700,000 a year --\$240,000 a year for offshore leases and \$460,000 a year for onshore leases. The estimated annual administrative burden of \$700,000 is less than one percent of the estimated potential annual savings resulting from acquiring royalty oil for the reserve.

Suitability of  
royalty oil

The Office of Strategic Petroleum Reserve letter states simply--without elaboration--that some royalty oil is not suitable for reserve storage. We agree that some royalty oil may not be desirable or suitable for the reserve because of such factors as its quality or geographical location; however, based on other information we have obtained, it appears a large majority of the oil would be suitable. According to a September 1977 report prepared by the Federal Energy Administration, about one-third of royalty oil production not taken in kind comes from the Louisiana offshore, 90 percent of which is low sulfur, light or intermediate gravity which is the type the Department plans to store in the reserve. In addition, we were informed by an Interior official that a major percentage of the remaining royalty oil not taken in kind would also be suitable for reserve storage.

Passing some of the  
cost of the reserve  
on to oil users

The Office of Strategic Petroleum Reserve letter states that if royalty oil is purchased for the reserve, the refiners that had been relying on royalty oil would have to buy higher cost, imported oil. Consequently, payment of some reserve costs would be transferred from taxpayers to oil users. We would like to point out that because the Department is now using the entitlements program to purchase oil for the reserve, some of the cost of the reserve is already being passed on to oil users. Although an additional increase in this passed-on cost would result from the Department acquiring royalty oil for the reserve, it would be very minimal, as the following calculations show.

In May 1978 the crude oil entitlement was \$1.63 a barrel which represented the difference between the average imported cost and composite refiner acquisition cost of crude oil for May 1978--\$14.49 and \$12.86 a barrel, respectively. The Department estimates that between August 1978 and July 1979, about 228 million barrels of oil will be placed in the reserve. All of this oil will be the higher priced imported oil;

consequently, during this period, the Department, through use of the entitlements program will pay about \$372 million less for this oil. This amount will result in increasing the price of oil by about \$0.06 a barrel. 1/ If the Department purchased 24 million barrels of royalty oil for the reserve rather than selling it to small refiners, this amount of lower priced oil would not be used in calculating the entitlements figure. Consequently, the resulting savings to the Federal Government of \$72 million would increase the crude oil cost by only \$0.01 a barrel. 2/

### CONCLUSIONS

The Energy Policy and Conservation Act requires that the cost to the Federal Government of acquiring oil for the strategic petroleum reserve should be minimized. We believe that if the Department purchased royalty oil not sold to refiners for the strategic petroleum reserve, substantial cost savings would result.

While we agree with the Department that acquisition of royalty oil will result in additional administrative burden, this burden, based on estimates by the Department of the Interior, is less than one percent of the estimated potential annual savings resulting from acquiring royalty oil for the reserve. Additionally, although some royalty oil may not be suitable for reserve storage, it appears a large majority of the oil would be suitable. Finally, although it is true that acquisition of royalty oil will transfer some of the reserve cost--\$0.01 a barrel--from taxpayers to oil users, \$0.06 a barrel is already being transferred to users through use of the entitlements program. Therefore, we believe, the potential savings far outweigh the problems the Department has identified in connection with purchasing royalty oil.

### RECOMMENDATION

To minimize the cost to the Federal Government of the strategic petroleum reserve, we recommend that you purchase

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1/This figure was arrived at by dividing \$372 million by the total amount of crude oil subject to the entitlements program in 1977--6.570 billion barrels.

2/This figure was arrived at by dividing \$72 million by 6.570 billion.

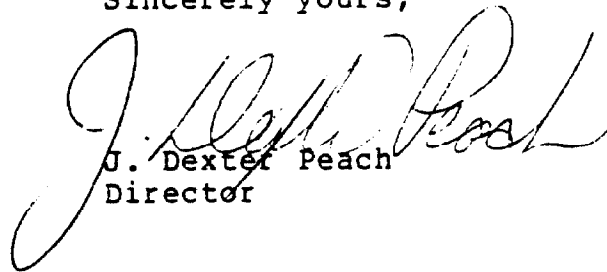
all suitable royalty oil for storage in the strategic petroleum reserve.

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Section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to the Director, Office of Management and Budget; the Chairmen, House Committees on Appropriations and Government Operations and Senate Committees on Appropriations and Governmental Affairs; and oversight committees for the Department.

Sincerely yours,



J. Dexter Peach  
Director



Department of Energy  
Washington, D.C. 20585

December 19, 1978

Honorable Jack Brooks  
Chairman, Committee on  
Government Operations  
House of Representatives  
Washington, D. C. 20515

Dear Mr. Chairman:

As required by Section 236 of the Reorganization Act of 1970, we are providing the following comments on General Accounting Office (GAO) report, "The Oil Purchase Policy Being Followed By The Strategic Petroleum Reserve", EMD 79-1.

The GAO examined various aspects of the oil purchase policy being followed by the Strategic Petroleum Reserve (SPR) and has recommended that the Department of Energy (DOE) "...purchase all suitable royalty oil for storage in the Strategic Petroleum Reserve." The GAO estimated an annual saving of approximately \$71 million to the Government.

We appreciate the GAO recommendations on this matter, but the Department continues to believe that it would not be appropriate to use royalty oil for the SPR. The primary impact of using royalty oil would be to reduce the costs of some of the SPR oil by passing a part of the oil costs along to petroleum users; the SPR would be getting lower-priced, price-controlled oil and forcing current users of that oil to buy higher priced imported oil as a substitute.

DOE agrees with the objective of reducing the cost of SPR oil. We have opted for an alternative means of obtaining SPR oil at a lower price through participation in the Crude Oil Entitlements Program, thus obtaining SPR oil at the national average composite price. This also results in passing a portion of the SPR oil costs along to petroleum users. We believe this approach is more equitable and administratively simpler than using royalty oil.

The use of Entitlements is more equitable because it does not disrupt established oil supplies to any U.S. refiners. Use of royalty oil would require some U.S. refiners to find alternative sources of supply or to work out complex oil exchange arrangements to meet SPR fill needs.


2.

Use of royalty oil for the SPR would be administratively more difficult than use of Entitlements. Much of the royalty oil is not of the quality required for the Reserve or could not be physically moved to SPR sites at reasonable costs; it would have to be exchanged for other oil in order to be utilized. Also, a number of difficult technical and logistic problems would require resolution (e.g., lease arrangements, delivery rates, schedule changes, exchange agreements, transportation) which would necessitate additional staff resources.

For the reasons set forth above, DOE does not believe that acquisition of royalty oil for the SPR should be pursued at the present time. If in the future we determine that utilization of royalty oil would be in the best interest of the SPR program, we would submit a SPR plan amendment to effectuate such a decision.

We will be pleased to provide any additional information that is desired in this matter.

Sincerely,

  
Dale D. Myers  
Under Secretary

cc: Honorable Frank Horton  
House of Representatives