DIESEL AND HOME HEATING OIL: PRICE AND SUPPLY ISSUES

JOINT HEARINGS

BEFORE CERTAIN

SUBCOMMITTEES OF THE COMMITTEES ON GOVERNMENT OPERATIONS

AND

INTERSTATE AND FOREIGN COMMERCE

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DIESEL AND HOME HEATING OIL: PRICE AND SUPPLY ISSUES

THURSDAY, JUNE 28, 1979

House of Representatives, Environment, Energy, and Natural Resources Subcommittee of the Committee on Government Operations, and Subcommittees on Energy and Power and on Oversight and Investigations of the Committee on Interstate and Foreign Commerce,

Washington, D.C.

The subcommittees met, pursuant to notice, at 10:10 a.m., in room 2154, Rayburn House Office Building, Hon. Toby Moffett (chairman of the Environment, Energy, and Natural Resources Subcommittee) presiding.

Members present from the Environment, Energy, and Natural Resources Subcommittee: Representatives Toby Moffett, Robert F. Drinan, Mike Synar, Arlan Stangeland, and Paul McCloskey, Jr.

Members present from the Energy and Power Subcommittee: Representatives John Dingell (chairman) and Edward Markey.

Members present from the Oversight and Investigations Subcommittee: Representatives Bob Eckhardt (chairman), Albert Gore, Jr., and Philip Sharp.

Staff present from the Environment, Energy, and Natural Resources Subcommittee: John R. Galloway, staff director, Steven J. Engelmyer, counsel, and Pamela R. Morrissette, office manager.

Staff present from the Oversight and Investigations Subcommittee: Richard Frandsen, counsel, Stephen F. Sims, special assistant, Jay C. Shaffer, counsel, and D. Ann Seyfrit, clerk.

Staff present from the Committee on Government Operations: Catherine Sands, minority professional staff.

Staff present from the Committee on Interstate and Foreign Commerce: Michael J. Stewart, minority counsel.

Mr. Moffett. The subcommittees will come to order.

Today, the Subcommittee on Environment, Energy, and Natural Resources, in conjunction with the Oversight and Investigations and Energy and Power Subcommittees of the Interstate and Foreign Commerce Committee continues its series of hearings on the diesel and home heating oil price and supply situation.

On Tuesday of this week, the Subcommittee on Environment, Energy, and Natural Resources conducted a hearing on home heating oil price and supply problems in Long Island and New England. Testimony was received concerning the failure of major refiners to renew their traditional contracts with Northeast home heating oil dealers.

Our hearing today will focus on the national distillate situation and the prospects of meeting the DOE goal of 240 million barrels of distillate inventory by October 1. Our witnesses will include representatives of three major oil companies and two State energy offices.

The testimony that will be received today will enable the three subcommittees to better understand the basis of the current diesel shortage that is raising economic havoc throughout much of the country and to possibly recommend appropriate actions to head off a potential home heating oil shortage this winter.

Specific points to be covered today will include the effect of the Department of Energy's recently revoked special rule 9. In granting agricultural users 100 percent of their claimed needs, the DOE rule appears to have worked to the great disadvantage of nonpriority diesel users, such as the trucking industry.

In our discussion with the oil company representatives, we will want to know whether they will reach their individual distillate inventory levels as recommended by DOE and if not, why not. We will also want to know how they view the upcoming heating oil season both in terms of price and supply.

We have a lot of ground to cover here today, and in order to give the members as much time as possible to question the witnesses, I have limited my opening statement to these few remarks.

Are there any opening statements by members?

If not, then we will proceed.

Before we hear from our first scheduled witnesses, the subcommittee has received a request and is pleased to grant it from Representative Berkley Bedell of Iowa.

The subcommittees are pleased to welcome the gentleman from Iowa who has testified before our subcommittee in the recent past.

You may proceed.

STATEMENT OF HON. BERKLEY BEDELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. BEDELL. Thank you, Mr. Chairman.

The reason I asked to appear before the committee is that yesterday I chaired a hearing on diesel fuel marketing practices that showed that questionable management decisions at several refining companies have helped aggravate the situation, at least in the Midwest.

This is a rather extraordinary event—a joint hearing by three subcommittees of two full committees. I think it is an accurate reflection of the importance of this subject. Our Nation faces a very serious and immediate threat in the form of inadequate supplies of diesel fuel and home heating oil.

Six weeks ago I chaired hearings in the Small Business Committee, to examine the diesel fuel supply situation and its impact on agriculture and small business. At the time, there was great concern that spot shortages of diesel would cause disruptions of spring planting in some areas, particularly the Midwest and Great Plains.

Those areas remain the most severely affected by diesel fuel supply problems, as the recent truckers' strikes bear witness.

But what we see there really is just the most readily discernable symptom of a bigger problem. The problem, quite basically, is that we are not producing enough middle distillate fuel to meet our Nation's requirements for diesel and home heating oil.

Unlike the situation with gasoline, there is little flexibility in our consumption pattern for middle distillates. We cannot ask people with even-numbered street addreses to heat their homes on one day and those with odd numbers to heat theirs the next. Planting and harvesting and agricultural shipments cannot be delayed. Surface mass transportation cannot be curtailed at a time of gasoline shortages. And our economy cannot function without truck transportation.

Current refinery production of middle distillates goes to two main uses: Distribution for immediate consumption as diesel fuel and storage for winter use as home heating oil. Right now we are not producing adequate levels for either one.

One of the reasons for the independent truckers' strike is their difficulty in obtaining adequate supplies of diesel fuel; they complain that special rule 9 diverted too much diesel to agricultural use. With special rule 9 being lifted, and the Interstate Commerce Commission authorizing passthrough of all added fuels costs, I am afraid that in another month or two we will have farmers protesting that they are being bid out of the market for diesel. There just is not enough of this fuel being produced to meet everyone's needs.

And the situation with home heating oil is equally bleak. In order to meet the goal of 230 to 240 million barrels of middle distillate in primary storage by October, we should be adding 7 or 8 million barrels a week to the inventory. This month, after a long period of declining inventory, we see statistics showing that we are now adding a little over 3 million barrels a week. At this rate, we may have a very serious shortfall. If this winter is as long as the last one, or as cold as the one before that, we may be in for big trouble.

As I say, this week's hearings at the Small Business Committee showed that there has been some bad judgment on the part of some major oil companies. And our May hearing did reveal some evidence of highly irregular market practices. We have shared with this joint panel's investigators our information regarding black market sales of diesel fuel.

However, what is utterly incomprehensible to me is the Federal Government's role in extending the middle distillate fuel problem. Yesterday we heard from the three oil companies with the worst problems in supplying their diesel customers, and they tell us that they have not received any clear message as to what the Department of Energy wants them to do, whether to emphasize production of gasoline or distillates.

One company told us that they are moving toward maximum diesel production; another is at maximum gasoline; and the third said that since the administration was only making voluntary compliance requests, they were not tilted in either direction.

The short-term prospect of even less gasoline and even longer gas lines is not a pleasant thought. But it is far superior to the alternative which is the prospect of running out of home heating oil this winter.

If these hearings accomplish nothing other than helping to persuade the administration to order an immediate tilt toward maximum distillate fuels and away from gasoline production, you will have done the American public a great service.

I thank you very much for the opportunity to come before you to at least express the concern which I have.

We have gasoline lines now but if we do not have any fuel to keep our homes heated, then we will know what a real problem is by this fall, in my opinion.

Mr. MOFFETT. We certainly thank the gentleman for his testimony.

I know the gentleman has been working hard on the distillate issue for quite some time now. We are pleased to work with the gentleman.

Are there questions?

Mr. Eckhardt?

Mr. ECKHARDT. I want to compliment the gentleman from Iowa for beginning this hearing by stating what I think is the very heart of the problem.

As the gentleman has indicated, diesel is the heart's blood of commerce. The problem of keeping diesel flowing and keeping trucks and trains and the commercial apparatus of the United States in operation is of absolutely vital concern. As he has pointed out, there is some flexibility with respect to the use of gasoline but there is little flexibility without recession in the use of diesel.

I want to compliment him for commencing this session with what seems to me to be the text of the entire hearing.

Thank you.

Mr. BEDELL. Mr. Chairman, let me mention one other problem that came up at our hearings. Essentially we leave the allocation system up to the oil companies at this time. In my opinion, there is no sense to the way they are allocating their supplies. I am talking about diesel supplies.

It varied completely with companies. One company had no method of allocation. They had a tremendous shortfall. They apparently just gave it to whomever came first.

One company simply delivered it to the pipeline and let the pipeline give it to whomever they decided to give it to. One company allocated it completely as a percentage of the contracts or orders that they had had, rather than based upon past purchases. It appears to me to be in a state of chaos.

Mr. MOFFETT. Again, we thank the gentleman for his testimony. We look forward to working with the gentleman in the future.

Mr. BEDELL. Thank you.

Mr. MOFFETT. Before we proceed to our next witnesses, the Chair is pleased to note that the distinguished gentleman from Michigan, the chairman of the Energy and Power Subcommittee of the Interstate and Foreign Commerce Committee, on which the Chair is also privileged to sit, has arrived and we welcome him. Mr. Dingell?

Mr. DINGELL. Mr. Chairman, I want to commend you and my colleague, Mr. Eckhardt, and the three subcommittees for moving into the inquiry into this compelling question of the adequacy of supplies of middle distillate and diesel oil during the time ahead.

It is my view the country will head into the upcoming winter season with a dangerously low supply of distillates, heating oil, and diesel oil.

We are already, according to Department of Energy estimates, about 28 million barrels below levels of this time last year. It appears in order to meet a desirable primary stock level of 240 million barrels of distillate by October that the Nation must increase our inventory buildup by 30 percent throughout the summer season. This will require strong action by the Department, the industry, and the American people. It will require not only production but some rather striking conservation undertakings.

It is my hope that we will meet this level. I must confess I have doubts that that will come about.

These hearings will allow us to examine what industry, the Department, the States, and what the Federal Government will be doing to insure adequacy of supplies of heating oil and middle distillates during the months forthcoming.

I hope that the inquiry will enable us to learn in detail the facts of the situation and also what the present statutory authority available to the Department is and whether it is adequate and being properly exercised.

The haunting spectre of heating oil costing nearly double last year's prices and still being in insufficient supply suggests that the committees will want to consider legislative action if it is demonstrated that the Department and the industry are not able to cope with what appears to be an increasingly critical problem.

With those comments, Mr. Chairman, I thank you.

I commend you and my colleague, Mr. Eckhardt, for your leadership and participation in this area.

Mr. MOFFETT. The Chair certainly thanks the gentleman from Michigan not only for his perceptive opening remarks and his participation in this hearing, but for his helpful advice and guidance over the past few years in the House.

At this time, the Chair calls to the witness table our first witnesses, Mr. Edward F. Wagner, vice president for volume management of Arco Petroleum Products; and Charles F. Tebo, manager of planning and analysis, Cities Service Co.

As you may know, we swear all of our witnesses routinely. If you have others who will be testifying they should be sworn in as well.

Please raise your right hand.

Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

[Chorus of "I do's."]

Mr. MOFFETT. Gentlemen, welcome to the subcommittees. We know that you have prepared statements.

Mr. Wagner, we will hear from you first. Please identify yourself and state your title.

STATEMENT OF EDWARD F. WAGNER, VICE PRESIDENT, VOLUME MANAGEMENT, ARCO PETROLEUM PRODUCTS CO., DIVISION OF ATLANTIC RICHFIELD CO.; ACCOMPANIED BY LEONARD BERKOWITZ, ATTORNEY

Mr. WAGNER. Thank you, Mr. Chairman.

I am Edward F. Wagner, vice president, volume management, Arco Petroleum Products Co., a division of Atlantic Richfield Co.

With me is Leonard Berkowitz, an attorney for the Atlantic Richfield Co.

We welcome the opportunity to share with you our views on the distillate situation this year, and especially Atlantic Richfield's response to the unusual situation faced by the petroleum industry this heating season.

I can assure you that no one in Atlantic Richfield—and we believe no one either in the industry or the Department of Energy—wants anyone to go cold this winter for lack of heating oil.

I am sure that you realize that the unusual conditions this year are a result of the international oil situation and the burgeoning domestic demand for gasoline and distillate fuels.

Our concerns then should address gasoline-distillate tradeoffs. The proper level and timing of inventories, the flexibility of the industry to respond to variations in the severity of the heating oil season, the effect of the rapidly escalating cost of crude oil—especially in the spot market—and distillate fuel oil prices.

In early May of this year, the Department of Energy suggested a national inventory level of 240 million barrels of distillate fuel oil as a target to be achieved October 5, 1979.

Based on our forecast of industry operations for the remainder of the summer, we would expect that an inventory level of only 190 to 200 million barrels will be reached by that date—some 45 million barrels less than the target.

The industry ended the 1978–79 heating oil season on April 1 with nationwide inventories of distillate fuel some 25 million barrels less than a year ago. By June 15, stocks were still down 23.5 million barrels from the prior year. As of the middle of June, it appears the stock accumulation level is falling behind the DOE's suggested program.

We understand that the 240 million barrel stock level represented a 9-percent increase over the level of last year. Such a level represents the high end of the range of inventory accumulation on this date over the past 5 years. Certainly a valid question is whether the country can afford this margin of safety and conservatism under the present conditions.

Looking at it another way, to reach the 240 million barrel target based on our present projection of performance to the end of September would require the conversion of about 45 million more barrels of gasoline to distillate. In the 92 days remaining in this period, that represents an additional reduction of about 7 percent in gasoline supplies over that which we are presently experiencing. We believe that a further cutback in gasoline supplies will make an already bad situation worse.

Distillate stocks normally continue to build beyond September and do not peak until late October or into November. We suggest that a 230 million barrel stock level for December 1 might be a more appropriate and attainable target.

Atlantic Richfield Co. has made its plans for the coming heating season on a different approach and has presented this approach to the Department of Energy in our discussions with them on the distillate situation.

On September 30, 1978, our distillate fuel oil inventory was 10.4 million barrels. Increasing this level by 9 percent would give us a September 30, 1979, target of 11.4 million barrels. Our present plans call for 9.9 million barrel stock level of No. 2 fuel oil on this date. While we do not project being at the target level on September 30, we plan to gain inventory over the fourth quarter with the projected year-end level at 10.2 million barrels—some 0.7 million barrels more than last year. By the end of the season, on March 31, 1980, we project an inventory of 5—about 1.2 million more than the very low level of this year when we were experiencing major supply disruptions.

We intend to accomplish our plan by gradually starting to switch from gasoline production to distillate production in August and continuing conversion during the winter while maintaining gasoline allocation during those months.

We believe that this approach reflects the realities of the present situation, that the motoring public needs time to adjust to lower gasoline supplies and the allocation procedure; that demand for gasoline is normally higher in the summer than the winter; and that the public should be more readily willing to make the tradeoff of gasoline for heating oil during the winter.

Between April 1 of this year and April 1, 1980—the end of the 1978–79 and 1979–80 heating seasons, respectively—we anticipate that we will have produced 1.6 million more barrels of distillate than we did during the prior 12-month period. Accordingly, we plan to reduce our purchases from other domestic sources to balance our system. Our reduction of purchases from other domestic sources should not alter the overall supply of middle distillates. Supplies from those other sources will undoubtedly reach the Nation's market, regardless of any decision by Atlantic Richfield not to buy.

On the premise that a normal winter will ensue, that the conservation ethic will prevail among consumers, and that natural gas supplies will amply maintain throughout the winter, our contractural obligations for middle distillate for the 1979–80 heating season should be met even in the probable environment of very tight supplies. Should any one of those premises fall short of expectations, we have retained in our plans some flexibility to make more middle distillate at the expense of gasoline.

The key assumption underlying all that I have addressed so far is that we will be able to purchase crude oil as planned.

Atlantic Richfield's crude oil supply has been seriously hurt by the Iranian unrest. Twelve percent of our crude supply originated from Iranian sources. In addition, we were dependent on the spot market for additional volumes.

We have been ordered by the DOE to sell 1.7 million barrels of crude oil in the period April through September of this year. Furthermore, we are continuing, under DOE regulations, to supply 65,000 barrels per day of crude oil to other major refiners under contracts which have expired.

We have repeatedly advocated that the DOE end mandatory sales of crude oil and gasoline to major refiners on the premise that such sales eventually drive up spot market and consumer prices.

We have been able to offset some of our crude losses with greater participation in the world's spot crude oil market to such an extent that we have been able to maintain refinery crude runs at 95 percent of capacity since the beginning of the year. We are planning to maintain refinery crude runs at 98 percent for the balance of the year, provided we can successfully negotiate for nearly 16 million barrels of yet unconsummated, though planned, crude oil purchases.

The success of our crude oil purchase negotiations will, of course, impact the price as well as the supply of home heating oils to our customers in all marketing areas.

We deem it contrary to the best interests of our customers—and the Nation as a whole—to bid up the premium prices on foreign crudes in competition with other refiners and other nations. However, to maintain high refinery capacity utilization, we have participated in the world market and to date have purchased about 24 million barrels of premium priced foreign crude. These purchases have been a significant factor in increasing our raw material costs by 25 percent since the first of the year.

During the first 6 months of this year we have purchased 2 million barrels of gasoline and 1 million barrels of distillate in addition to spot purchases of crude oil. Since January 1, 1979, in markets both at home and abroad, spot cargo prices for gasoline and middle distillates have risen twofold to levels of about $1 a gallon. Those price increases reflect free world competition for limited supplies further stimulated by this Nation's subsidation of middle distillate imports through the DOE's entitlements program.

In view of our present situation, we see no alternative but to continue our participation in the world market if we are to fulfull our crude oil needs and to attempt to recover in the marketplace, crude oil costs incurred.

In any event, Atlantic Richfield will continue its compliance with the President's wage and price guidelines for petroleum refiners.

Concerning the proper balance between gasoline and middle distillate production, Atlantic Richfield believes that balance should be sufficient to meet the seasonal needs as best we can for each product. We have chosen not to take on new customers but to judiciously apportion our product supply consistent with our obligations.

Because of the imbalances resulting from high first quarter 1979 light product demands in the face of limited crude supplies, we elected to allocate gasoline and restrict distillate sales beginning March 1. Our intention was to insure that sufficient gasoline would be available during the driving season to at least meet the needs of our customers, albeit on an allocated basis, without unduly sacrificing middle distillate production.

Despite limited supplies, Atlantic Richfield has a summer fill program in effect in the Northeast as well as our other distillate fuel marketing areas east of the Rockies. The summer fill program offers a heating oil and kerosene reseller the opportunity to build both his and his customers' inventories during the off-peak season.

The reseller may take delivery of product during June, July, August, and September and defer payment on this product until October 10. The price for each delivery is the lowest applicable price at point of delivery from the date of that delivery to August 31.

Concerning contract renewals, in 1976 we offered supply agreements to all of our existing distillate resellers under which we agreed to sell during each year of the agreement an annual minimum volume of distillate. The minimum volume in those agreements was 70 percent of a maximum volume, which was selected by the reseller, and the reseller certified that the maximum volume did not exceed his best estimate of his requirements.

Since 1976, Atlantic Richfield has counseled its resellers that we will terminate the agreement for breach in the event the reseller fails to purchase the annual minimum volume. This policy was instituted so that the distillate which the company is contractually committed to sell would be purchased by the reseller to whom these products were committed.

It is the company's position that in the event the reseller fails to purchase the annual minimum volume, the agreement will be terminated and the volumes redistributed where they are needed. This policy is currently continuing in effect. Through the application and enforcement of this policy, Arco has been able to maintain in full effect, all of its contract obligations.

Historically, our contracted resellers have purchased on average, approximately 80 percent of their contract minimum. This was because most resellers had more than one supplier. Therefore, upon the anniversary date of our agreements, we will offer to all contracted resellers who are not in default a new agreement with a maximum volume equal to 80 percent of the maximum volume of their prior agreement.

We expect to return to supplying maximum contract volumes as soon as possible. We think this can be accomplished in September unless unusual circumstances develop. This will then provide that under our new agreement resellers will, on average, be able to purchase the same volumes they have in the past.

In closing, we submit there are no easy answers. We lay no claim to infallible judgment. But we do believe that we have an obligation to maintain a reasonable balance between gasoline and middle distillate supplies.

It is our perception that this is what the Federal Government also wishes us to do, recognizing that gasoline would be allocated beyond mere inconvenience if cold weather dictates high heating oil demand this winter.

If there was concern on the part of the Government that supplies should be biased toward distillates, then certainly it would have implemented a plan to curtail gasoline consumption through rationing.

Short of such action, we have balanced supplies of both gasoline and distillates to match our limited avails.

We believe the limitations will impress people with the absolute necessity to conserve both gasoline and distillate.

There really is no other choice.

Thank you.

Mr. MOFFETT. Thank you.

Mr. Tebo?

STATEMENT OF CHARLES F. TEBO, MANAGER OF PLANNING AND ANALYSIS, CITIES SERVICE CO., TULSA, OKLA.

Mr. TEBO. Thank you, Mr. Chairman.

My name is Charles F. Tebo, manager of planning and analysis, Cities Service Co., Tulsa, Okla.

Cities Service welcomes the opportunity to provide input to this committee. We feel that only with this type of discussion will our energy problems be understood and be dealt with properly by all agencies of government, the oil industry itself, and the public.

The committee has requested specific comments to four questions. Prior to addressing these items, an overview of our middle distillate situation will be helpful.

In 1978, Cities sold 24.8 million barrels of No. 2 fuel oil and diesel, which was a record high level.

For the first 5 months of 1979, sales ran 23 percent higher on the comparable period last year. Demand was unusually strong for that time of year, and we met that demand by drawing down inventories to an all-time low.

A question we ask ourselves is: Where did this extra 23 percent go? The increase was not weather related because in PADS I and II, where we sell most of our heating oil, the weather was actually warmer than the first quarter of 1978.

We sold some new customers, many of whom had been spot market buyers in the past. We think some of the product was purchased early to be put into secondary storage to beat price increases. We think that businesses have stockpiled some product due to price reasons plus to avoid the shortage problems that occurred for business firms during the embargo.

For the entire year of 1979, we expect to be able to sell 20 million barrels, or 81 percent, of the 1978 level. This production level has been increased as recently as last week when we made decisions to maximize distillate production.

This sales and production projection is based on crude oil availabilities of only 255 million barrels a day, or some 35 million barrels a day lower than our capacity. The volumetric shortfall of crude is compounded by the shortage of the proper types of crude which significantly affects our product yield slate and sulfur specifications of our fuel oil.

Currently, we are restricting heating oil and diesel sales to a 50-percent allocation fraction for several reasons:

First, extremely low inventories casused by the higher sales and lower production estimates for the next several months.

Second, the need to build inventories to a minimum operating level, or 7,100 million barrels, to avoid disastrous runouts in the peak heating months of January and February. With our refinery located on the gulf coast and our heating oil sales in the Northeast and Upper Midwest, we must have this level of inventory in place because pipeline shipments and tanker shipments require long lead times in the peak season. If we do not have inventories at this level, we will have terminal outages in the coldest months.

Third, the inability to purchase spot market fuel oil to supplement our own supplies. Traditionally, Cities purchases 4 to 5 million barrels of distillates per year to meet our sales demand. We question if we can buy any this year due to a very wide differential in price between the spot market and our selling price to our customers, plus the lack of available spot fuel oil to any price.

Fourth, excess sales of diesel fuel above our normal sales due to the certification of priority users by the Department of Energy.

By selling at this 50-percent average level between now and the end of year, we project that we can sell or allocate at a 90 percent to 95 percent level during the coldest months; namely, January and February. We further feel that this sales level will cover 100 percent of demand due to anticipated conservation by the home heating customer, primarily because of higher prices.

The 50-percent level and the 90-percent allocation level could be lowered in the event less crude oil of proper type is available and/or the volumes sold now to priority customers continues to escalate. Other problems such as labor interruptions or mechanical failures could also be negative factors.

In view of this less than optimistic outlook, what can we do as a supplier to better meet demand?

We plan to continue to look for reasonably priced supplemental finished product.

We will attempt to acquire higher volumes of crude oil.

We plan to maximize yields and fill storage to the best of our ability.

On the governmental side, it would help a great deal if State governmental agencies in the Northeast would, at least temporarily, waive their minimum sulfur specifications on heating oil. This waiver is needed now, but it usually comes in the middle of a severe shortage when the higher sulfur product is in another part of the country and it is too late to avoid hardships.

Another positive action that could be taken by DOE to help our heating oil customers is to end the mandatory crude oil sales of 8,000 barrels per day of our best quality crudes to small refineries.

This action does much more than shift a shortage from one group of customers to another. In our case, with our refinery hardware, we could convert this 8,000 barrels per day into desirable light products. Presently, this 8,000 barrels is most likely being converted into some gasoline, some distillates, a high percentage of heavy oils and asphalts. It would serve the consumers better if we refined our own crude oil rather than have to sell it to less efficient refiners.

Now, allow me to address the four issues covered in your letter:

The first subject—Cities' projection of supply and price this winter.

Our reply—We have already commented on our supply outlook. Regarding price, we would expect our price to rise in direct proportion to crude oil increases in price. Without knowing OPEC's final price increase, the price mixes of domestic oil, or spot market prices of both crude and finished product, we nevertheless project an increase in today's overall crude oil prices of about 7 to 9 cents per gallon which could be expected to be passed on into light products such as heating oil, diesel, and gasoline.

That is our guess, but we have no idea of our competitions' projections or plans or even if they agree on the crude price increases.

Today's price, as a point reference in Philadelphia is 59.15 cents per gallon into delivery trucks on a wholesale basis and increased crude oil prices probably will be added to this current price.

The second subject—Cities' own home heating plans for this winter.

Our reply—We do not market directly to homes, rather we sell to independent wholesalers. Our game plan is to supply these customers to the best of our ability to levels close to their needs.

The third subject—Status of Cities' summer-fill program and contract renewals.

Our reply—A summer-fill program was not considered this year because we have insufficient quantities of product to devote to secondary storage. However, as stated earlier, some of our high sales volumes in the first 6 months have probably gone into secondary storage. This inability to fill secondary storage could cause some problems later in meeting demand when cold weather hits, but in Cities' case, we estimate that a high percentage of our volumes sold in summer months traditionally never went into secondary storage, rather it was sold on normal terms to summer users of distillate, but included in our summer-fill program. Regarding contracts, Cities continues to renew contracts to its customers on normal terms, with 10-day discounts, as we have in the past. The number of customers on contract is consistent with or higher than in previous years.

The fourth subject—Cities' views on rule 9 for agricultural and other priority users. While this regulation was changed on June 21, we will comment on it anyway because of its impact on us.

Our reply—We feel that the farmer and some other priority users warranted preferential treatment, and we voluntarily instituted our own priority plan based on historical purchases by our customers who have farm businesses. This plan would have worked well, but was preempted by the Federal regulations. Rule 9 mechanisms for upward certification allow for unreasonable upward requests and highly suspicious claims by some wholesalers.

For example, our 50-percent fraction in May was actually raised to 71 percent after all certifications came in.

In June, our sales will increase 10 percent over our controlled fraction due to rule 9.

By the end of June, we will have sold some 15 to 20 million gallons over and above our original estimate as a direct result of upward certifications. This means that we have no chance to attain our DOE inventory target of 8 million barrels in October and may be prevented from reaching our minimum operating inventory of 7 million barrels by yearend.

Special rule 9 is being abused. Some customers certify that their nonallocable requirements are higher than we have ever sold to them in the past. It is common to receive certifications indicating that 100 percent of some wholesalers' business is nonallocable, which is difficult to believe.

We reject the obvious violators and usually get lower certifications from them. We are also protesting to the regional DOE offices about reasonable requests, but without many positive results to date.

When considering all regulations or volume directives, one must never forget that these laws do not add a single gallon to supply. Rather, they only reduce one customer's allocation while increasing another. Distillate volumes that are sold in unreasonable amounts now, will only aggravate an already serious supply problem this winter. In our opinion, suppliers could have allocated volumes to priority users on a voluntary basis much more equitably than rule 9.

In closing, we believe that with a normal winter, the industry will meet heating oil demand if a host of new regulations with their constant changes are not introduced and implemented. While available product volume will be lower this year compared to last year, with consumer conservation and an all-out effort to distribute available supplies on a fair and equitable basis through normal distribution channels, the problem can be minimized if not eliminated. Hopefully, the State energy offices will not get into the heating oil supply and distribution business and allow the industry, both suppliers and wholesalers, to function efficiently. We do not need State or Federal agencies, despite their good intentions, good motives, to interfere with the day-to-day distribution of product because of the inequities always built into special rule 9-type programs.

Thank you for your interest and I will be pleased to respond to any questions you may have.

Mr. MOFFETT. The Chair thanks both of you gentlemen for your testimony.

I would like to begin by determining how Cities Service relates to the Department of Energy goal of 240 million barrels of middle distillate and primary inventory by October 1. Last year Cities had 8 million barrels of distillate in inventory on October 1, as I understand it. Will you have the same 8 million barrels of inventory plus that 9 percent that DOE has called for on October 1?

Mr. TEBO. On October 1 we will have something like 5 million barrels in our storage, primary storage, and about 7.1 million in December.

Mr. MOFFETT. So, last year you had 8 million in October and this year you will have 5 million in inventory on the same date?

Mr. TEBO. That is right, Mr. Chairman.

Mr. MOFFETT. You noted in your opening statement that for the entire year of 1979 Cities will sell 20 million barrels of distillate. Is that right?

Mr. TEBO. That is correct.

Mr. MOFFETT. That is 81 percent of the 1978 level?

Mr. TEBO. yes.

Mr. MOFFETT. The 7 million that you are talking about having on December 1 is the rock bottom minimum, isn't it?

Mr. TEBO. It is the rock bottom minimum, yes.

Mr. MOFFETT. To avoid disaster?

Mr. TEBO. That is right. That is why we are on the allocation that we are on now.

Mr. MOFFETT. That is why you are going to 50 percent of contract levels from now through December 1?

Mr. TEBO. Yes. That is contract levels based on what the man purchased last year.

Mr. MOFFETT. In other words, if you increased your allocation fraction above 50 percent from now through December, you feel you would not reach your December inventory target which could lead to home heating oil shortages.

Mr. TEBO. That is absolutely true.

Mr. MOFFETT. We can certainly understand your not wanting to get yourself in a position where you are unable to supply your customers with heating oil in January and February. We can be very sympathetic to that concern. But, by reducing your sales by 50 percent from now until January, it seems like you are running the risk of having the terminals run dry in, let's say, November or December.

Mr. TEBO. Are you talking about the secondary terminals or the primary?

Mr. MOFFETT. Your terminals.

Mr. TEBO. Our terminals will get by. The demand is much lower in normal sales in November and December than they are in January and February.

Mr. MOFFETT. How do you know that? I do not think it necessarily follows that you are going to get by in November and December.

Mr. TEBO. We will still be allocating at the 50-percent level in November and December. We have taken those sales estimates into consideration with our production and our ability to stockpile.

Mr. MOFFETT. How about the wholesale terminals?

Mr. TEBO. The secondary wholesale terminals could be a problem. In Cities case, most of our distributors do not have secondary storage. Only 5 to 8 percent of our volumes sold in the summer ever went into secondary storage.

Mr. MOFFETT. What do you mean when you say that it could be a problem? Could the wholesale terminals be empty?

Mr. TEBO. If a man is located far from a primary terminal and if a cold snap should hit, he could have logistical problems early in the heating season.

Mr. MOFFETT. Logistical problems?

Mr. TEBO. Yes.

Mr. MOFFETT. In other words, be out of oil.

Mr. TEBO. Yes.

Mr. MOFFETT. For what period of time?

Mr. TEBO. A day or two. It would not be very long. It could be managed.

Mr. MOFFETT. In 3 or 4 days?

Mr. TEBO. Yes, at the maximum.

Mr. MOFFETT. What happens then? What does the dealer do?

Mr. TEBO. He anticipates the shortage and delivers to his customers a smaller amount in each delivery to tide him over until his inventories will be built up.

I mentioned that we will be on what we consider to be 100 percent of allocation compared to demand when the season really hits.

Mr. MOFFETT. What if the dealer who tries to anticipate an outage and is going out and shopping around for fuel and finds that the other operators in the area are short fuel at this same time in November and December—as Cities is—or, for example, what if the retailers who rely on you are unable to buy fuel from other retailers, then what about that? Do you know for a fact that your dealers will be able to prevent anyone from going without heating oil in November and December?

Mr. TEBO. No, we do not know that for a fact whether they will or they won't. It is weather-related. But we do have the flexibility to draw down inventories early in the year, early in the heating season in November and December, if that should occur.

Mr. MOFFETT. So you do not know for a fact, Mr. Tebo, that we will be able to avoid a situation where people go without heat for periods of time.

Mr. TEBO. No, I do not know that for a fact, Mr. Moffett, but I feel that it can be managed. It would be a minimal disruption.

Mr. MOFFETT. You could see a situation where we had midnight deliveries by dealers to try to get people through the night and the next day?

Mr. TEBO. Yes, I can visualize that. The same thing as happened during the embargo.

Mr. MOFFETT. The anticipated conservation on heating oil that you talk about coming in your view mainly from higher prices—I take it that you are assuming that we will see a 10 or 15 percent cutback in heating oil over the coming year.

Mr. TEBO. That is our projection. After the embargo there were deliveries to homes and they were about 15 percent lower than they had been before the embargo. We anticipate another 15 percent.

Mr. MOFFETT. Is it not true that your assumption about getting through the winter, that is your getting through the winter in terms of being able to cover demand is based on that conservation happening?

Mr. TEBO. It is based on the normal fall weather and it is based on some conservation, yes.

Mr. MOFFETT. Normal fall weather and conservation, and if those things do not happen, then you do not think you will be able to meet your demand in January and February?

Mr. TEBO. We will have to option at that time to supply more product during November and December at the expense of January and February. This is undoubtedly what we would do.

Mr. MOFFETT. Rob Peter to pay Paul?

Mr. TEBO. That is right.

Mr. MOFFETT. Where is this conservation going to come from? We had testimony earlier this week from the New England Fuel Institute, for example, that heating oil demand in New England is down 14.5 percent since the Arab embargo.

I have seen the efforts that people are making to conserve fuel firsthand. I think other members here, particularly those from the North and Northeast have seen how people are shutting off rooms in their homes, how they are wearing heavy sweaters, and how older people are getting sick because they turn their thermostat down a little too far. Where is this 15 percent savings going to come from?

Mr. TEBO. Just what you are talking about. We don't think people have done that yet. We think the 15 percent that came after the oil embargo was a matter of turning down the thermostat from 74° to 70° or 68°. We think it can go lower than that. We know the businesses are mandated by governmental action to lower the temperature in their buildings.

I think that will add to another 15 percent. Of course, we talk about various other things that can be done.

I mentioned in my testimony the sulfur specification being lowered——

Mr. Moffett. We understand that. But now we are talking about the elderly person and others and what they have done to conserve. It is your testimony and I do not want to put words in your mouth. But as I understand it, it is your testimony that they really have not scratched the surface yet on conservation. In other words, some of them have turned down the thermostat, but there is more that can be done and there is still fat in the system that will permit a 15 percent cutback. So, how much of your assumption about conservation comes from an assumption that people are going to have money to shell out to put on storm windows and have insulation and so forth?

Mr. Tebo. In the Northeast where we sell the majority of our heating oil the storm windows, of course, have already been on and they have been for years. It has been a normal practice.

Yes, there is some fat in the system. There is also some conservation to be had yet, and we think it is going to happen this year.

Mr. Moffett. I have one final point before I yield to my colleagues.

On page 3 you state "In view of the less than optimistic outlook" for heating oil this winter that Cities will, and I quote, "Look for reasonably priced supplemental finished product."

I assume you are referring to spot market purchases.

Mr. Tebo. Yes, that is correct.

Mr. Moffett. From a profit and loss standpoint Cities does not want to be a position of meetings its contractual obligations on the basis of high priced spot purchases. Is that not right?

Mr. Tebo. We have met with our customers. We have gathered them together and proposed the situation where we would buy some product at the 90- to 95-cent-per-gallon level. We have asked them if they could stand a price rollthrough or would they rather be on a lower allocation. They chose the latter.

We will keep polling our customers.

Mr. Moffett. So, the higher the spot market price the less oil you would be inclined to purchase; right?

Mr. Tebo. The projections that I have now for the 81 percent of volume issue versus last year assumes no purchases. Any purchases we could make would add to that number, and we have very recently purchased over 1 million barrels of very high-priced spot market crude oil which will help.

Mr. Moffett. What is your best estimate of what the cost of home heating oil is going to be this winter? I am talking about retail.

Mr. Tebo. I gave the guess that we have. Our price presently to the wholesaler is 59 cents in Philadelphia and it goes up the 7 to 9 cents I am talking about—that makes it 68 cents. I assume the retailer and his distribution channel has another 15 cents. So you are talking about 85 cents, roughly. That is a rough calculation. We have no idea what the retailer marks it up.

Mr. Moffett. I guess it then could be $1; right?

Mr. Tebo. I do not think so, but close.

Mr. MOFFETT. Thank you.

The Chair recognizes the distinguished subcommittee chairman, Mr. Eckhardt.

Mr. ECKHARDT. I understand that you both are disagreeing with those who say that the barrel should be broken more favorably to distillates so as to product by October 1 of 1979 approximately 240 million barrels of middle distillates. Is that generally correct? You feel that you can make this but that you should spread that out a bit more so that you peak in November and December in the production but do not use the target date of October 1 with that quantity of middle distillate? Do I state your position correctly?

Mr. TEBO. In our case, sir, we already switched to the maximum distillate yields. We have already turned the valve, so to peak, at the expense of gasoline.

Mr. ECKHARDT. So you essentially are doing as much as you can in that direction.

Mr. TEBO. Yes, much earlier than we would normally do it.

Mr. ECKHARDT. There is a 5-percent swing from gasoline to middle distillates. You have already used that approximate 5-percent swing?

Mr. TEBO. That is correct.

Mr. ECKHARDT. In the case of Arco, I guess what I said is about correct?

Mr. WAGNER. Yes. What you initially said was our position.

Mr. ECKHARDT. With respect to Arco's position, if you follow the policy that you are suggesting, you will be constantly utilizing that crude oil which you can get at the time to make middle distillates, so you will be producing more heavily toward the middle distillates the later the time occurs; is that correct?

Mr. WAGNER. As I indicated in my prepared remarks, we intend to begin to produce, if you will, into the distillate mode of operation in August and then continue that right through the winter through the first quarter of next year.

Mr. ECKHARDT. But at each given time you are using that crude oil which you are bringing in to your refinery at the then price. Is that correct?

Mr. WAGNER. Yes; that is correct.

Mr. ECKHARDT. So, what you will be using for the making of products with the emphasis on gasoline before you tilt toward middle distillates will be a relatively lower priced crude than that which you will be using at the time that you tilt toward middle distillates, presumably; is that not correct?

Mr. WAGNER. You are assuming—that is, you are making some assumption of crude oil price which I cannot make at this time. We will probably know more by the end of the week.

Mr. ECKHARDT. I think we are awfully naive if we think that crude oil price are not going to go up. Certainly that has been what has been happening for years. Isn't that correct?

Mr. WAGNER. Yes; that is correct.

Mr. ECKHARDT. Also, you may expect to have to get, unless, of course, the Saudis begin to produce more crude oil to fill the gap, a larger proportion of crude oil on the spot market. Is that not correct?

Mr. WAGNER. I suggested to you in my prepared remarks that Arco has already bought through 7 months of this year substantial quantities of crude oil for which we have paid premiums, substantial premiums.

What the price then is of crude oil for the last 5 months of the year is versus what we have paid recently, we do not know at this point. However, we are prepared to buy additional crude oil and, depending on what the price is, it is going to have to costed into the product.

Mr. ECKHARDT. We do know, however, that through 1977 and 1978 that the contract price which was essentially the average price of diesel fuel ran fairly constantly around 36 cents per gallon. Is that not correct?

Mr. WAGNER. I do not know what you are referring to.

Mr. ECKHARDT. My figures indicate that No. 2 diesel wholesale ran through 1977, beginning in January, at about 34.3 cents and by December it was 36.6 cents, and then it ran through 1978 to a high of 39.1 cents. In most months it was 36 something.

Mr. WAGNER. I presume you are reading some industrial report.

Mr. ECKHARDT. I am reading the Monthly Energy Review of DOE.

Mr. WAGNER. I will accept that number as reflective of an average price.

Mr. ECKHARDT. I understand from the testimony that has been given here this morning—before I mention that let me say this. The same source indicates that the price of diesel fuel in 1979, January and February, was 39.7 and in February 41.8. I understand from your testimony here that it is approximately 60 cents at the present time. Do I state that reasonably accurately?

Mr. WAGNER. I believe the other gentleman quoted a price like that.

Mr. ECKHARDT. Yes; I think that was it.

Mr. TEBO. The price I quoted was a Philadelphia, Pa. price. We sell the higher percentage of our diesel fuel in the South and it would not be that high.

However, I think you are in the ball park.

Mr. ECKHARDT. It would be about 60 cents, particularly if you average in the diesel bought on the spot market which I think you have stated here runs about $1 at the present time.

Mr. TEBO. Without knowing the exact numbers, I would guess that Cities' diesel price is about 55 cents. That is a guess. But you are in the ball park.

Mr. ECKHARDT. I am suggesting that we may expect a continued increase in price in diesel fuel unless there is a sufficient buildup of stocks. A threatened shortage or perceived shortage is going to tend to bid up the price, particularly if we have an increased cost of crude oil.

Mr. TEBO. I think that is essentially correct.

Mr. ECKHARDT. I thank the gentlemen.

I thank you, Mr. Chairman.

Mr. MOFFETT. The Chair thanks the gentleman.

The Chair now recognizes the gentleman from Tennessee, Mr. Gore.

Mr. GORE. Thank you very much, Mr. Chairman.

I would like to thank both of the witnesses for their testimony this morning.

I am interested in the systemwide inventory. Both of you have indicated that at your company terminals you have intended to have the supplies in the beginning of the winter which are below last year's supplies. If you are now on allocations throughout the year, are not the secondary storage and the tertiary storage going to be far below what they were last year and therefore will not systemwide inventory be much lower?

Mr. TEBO. I would think that is essentially correct.

One of the factors that we took into consideration in having our 50-percent allocation is that hopefully some of our customers could find products from someone else during the winter to put it into secondary storage, plus the fact that some of the early sales that we had this year undoubtedly went into secondary storage.

However, essentially you are correct—we would not expect the secondary storage to be as full as it was in the past years.

Mr. GORE. Therefore, your figures may be excessively optimistic because you are saying that your customers who normally contribute to systemwide inventory for secondary and tertiary storage, that is, you are counting on them to be able to give it to somebody else.

Mr. TEBO. Yes; and we have reason to believe that some of that is going on.

Mr. WAGNER. I talked about heating seasons now. In the upcoming heating season we will supply about 6 percent less. In other words, our sales will be about 6 percent less than they were in the heating season just passed.

We are not allocating distillate. We have contracts for distillate business. As I mentioned at the start, presently customers are receiving the minimum under that contract. Beginning the first of September they will receive at 100 percent of the contractual volume.

In total, however, we would expect to supply or sell to our customers in this heating season, slightly less than a year ago.

We do not believe that that 6 percent is a number. We think that with some conservation that that will be a reasonable number that we can probably live with.

Mr. GORE. That figure, Mr. Wagner, is subject to various interpretations. I represent a district in Tennessee. Arco completely pulled out of the Tennessee market late last year. The people who used to rely on you, about 10 percent of the diesel market and as everybody knows, the diesel and home heating oil are essentially the same thing, they will have to go elsewhere.

A company called Publix Oil assumed the Arco contracts and the Arco jobbers, but it had to buy on the spot market to meet its requirements because it had no base period supplier.

In our current shortages with the exorbitant spot market prices, this company is unable to get the supplies that it needs and that its customers need.

DOE issued an order last week requiring seven other companies to supply Publix with the product but so far only one has complied with the order.

Why did Arco completely pull out of Tennessee?

Mr. WAGNER. We began the withdrawal from the Tennessee market along with a number of others in that area several years ago. We sold the refinery at East Chicago, Ill. It was sold to another company.

At that time, we pulled out from large sections of the Tennessee and Kentucky, and southern Ohio, and Indiana, and Illinois market.

Mr. GORE. This is an extremely serious situation that the country is facing. There are two crisis periods. I would like to emphasize this.

The first is going to come in September when we face the harvest season. We are going to have three groups of customers competing with each other for diesel and heating oil which together make up the distillate products.

The peak demand for farmers is in the summer, but there is a second peak. In September it is almost as high. When that comes, we are going to have farmers and truckers, and people in the Northeast who use heating oil, all competing for supplies of distillate that are not going to be there in the amounts that we need.

In January and February, we face a second crisis period. That is during the peak of the winter. We are at the mercy of nature if we have an extremely cold winter, and we would then face a very critical problem this winter.

I would like to get both of you gentlemen to comment on this. But I think we need to take several actions right now. I think we need to enforce a stepped up effort to substitute natural gas for distillate in those industries that can make the substitution.

I think we have to force the refineries to step up their total output, not only of gasoline but also of distillates.

I think we ought to increase the distillate fraction that is coming out of the refineries.

I think the Congress has got to work quickly to have a gasoline rationing plan to make up for the shortfall that that increased fraction of distillate is going to cause. I think, we ought to move immediately to allocation controls on distillate, and I think the Department of Energy should make plans right now to get those pumps in the strategic petroleum reserve ready to operate and to have plans for distributing that oil and the refined product as a result of the oil pull out of the strategic petroleum reserve so that we will not have to face the winter with no ability to bring it out.

Mr. TEBO. Speaking for Cities Service, we would agree with a lot of what you have said. We would like to increase the total at the refinery, but the only reason we are not is that we do not have the crude oil. Many, many of our foreign contracts have been forced majeure canceled and we would love to run it at full out capacity. We are about to make the switch on the maximum distillate program.

Mr. GORE. Cities Service has been one of the hardest hit on supply, but overall oil stocks are higher than last year and imports are higher than last year.

Mr. TEBO. Not ours.

Mr. ECKHARDT [presiding]. The gentleman's time has expired and we must recess briefly to vote on the floor of the House.

The subcommittees will have a short recess.

[Recess taken.]

Mr. MOFFETT [presiding]. The subcommittees will resume their sitting.

We apologize for the interruption. I am sure that you understand that this happens frequently. There is not much we can do about it.

Mr. Wagner, from your testimony it appears that Arco rather than having the 11.4 million barrels of distillate in inventory on October 1, as called for by the Department of Energy, will have an inventory level of 9.9 million barrels. That is about 1½ million barrels less than called for by the DOE. Is that correct?

Mr. WAGNER. That is correct.

Mr. MOFFETT. The 9.9 million barrels planned for October 1 is a half million barrels less than last October 1; is that right?

Mr. WAGNER. That is correct.

Mr. MOFFETT. Last year the industry as a whole went into the heating season with inventories considerably less than the two previous years, as I understand it. Is that right?

Mr. WAGNER. I do not have those numbers.

Mr. MOFFETT. Our figures seem to indicate that.

Mr. WAGNER. I do not have the numbers at my fingertips.

Mr. MOFFETT. Does it sound like a correct statement? The figures that I have indicate that on October 1, 1978, there were 220.8 million barrels, in 1977 there were 252.8 million barrels, and 1976 there were 232.2 million barrels of middle distillate in primary inventory. In 1975 there were 220.7 million barrels.

Mr. WAGNER. Those sound like reasonable numbers.

Mr. MOFFETT. That is the Department of Energy's data.

Insofar as Arco is concerned, Arco's projected October 1 distillate level of 9.9 million barrels is not only one-half million barrels lower than your October 1978 level, but it is approximately 1.7 million barrels lower than October 1977, and 2.4 million barrels lower than 1976. From a historical perspective, Arco's projected October 1 distillate level this year is considerably below normal. Isn't that right?

Mr. WAGNER. That is correct. However, in my prepared statement I pointed out to you that our December 31 inventory is higher than a year ago. This is really, as far as we are concerned, the real critical point because it is in January and February when the demand is the highest.

As I pointed out, we are some 700,000 barrels higher than we were this past year.

Insofar as those of us who have large commitments, certainly in the Northeast, that number is, without a doubt, the year-end inventory. That is more critical than when it happens to be on the first of October.

Mr. MOFFETT. I take it from your testimony that Arco's distillate inventory will peak this year on December 31?

Mr. WAGNER. Yes; we are doing that. That is the point I want to make. We are doing that by limiting gasoline production from August onwards. In order words, this is the point I am trying to make to you. We see no change in the gasoline supply situation. In fact, we will continue to allocate gasoline through the end of the year and into the first quarter.

We are purposely turning gasoline into distillate. We are doing it beginning in August. We think this is the way to do it.

Mr. MOFFETT. Is it not traditional for both the industry as a whole and for Arco to reach the peak inventory levels not in December, but in October, and November? The demand peaks in December; doesn't it?

Mr. WAGNER. The industry has peaked as late as—I believe you can look back some years and it has peaked as late as late November and sometimes early in December.

Mr. MOFFETT. Not at these levels. We are talking about considerably lower levels. Those peaks are lower than the other years that we might look at; right?

Mr. WAGNER. We have peaked anywhere—we do not use, normally, September 30, even in our normal planning. We tend to look more at November 1. We normally would peak sometime in November.

Mr. MOFFETT. Without objection, the Chair would introduce exhibits A, B, and C into the record.

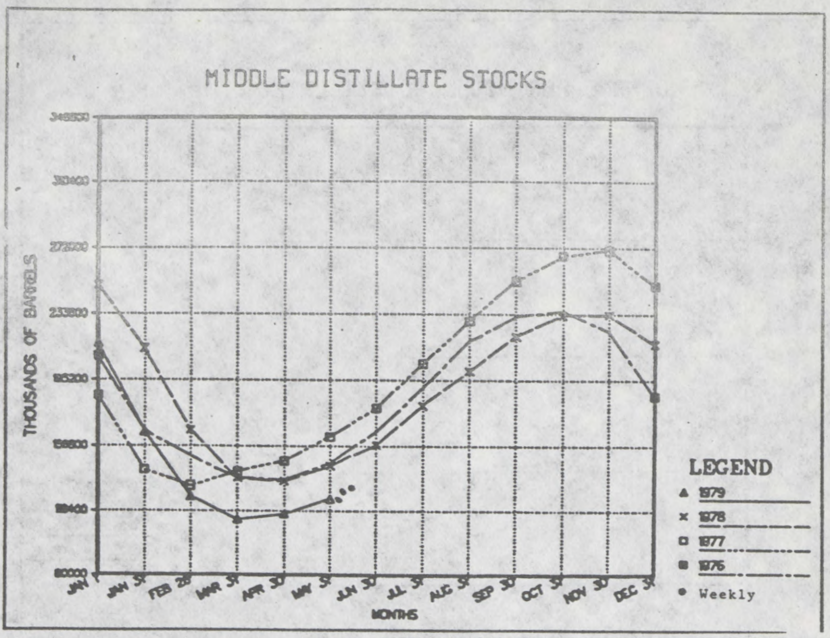
Exhibit A is the Department of Energy graph showing the industry distillate inventories for 1975–79.

Exhibit B is a DOE graph showing distillate demand for 1975–79.

Exhibit C is the Arco answer to the New England caucus questionnaire showing Arco distillate inventories for 1976–77 and 1977–78.

These will be entered into the record at this point.

[The material follows:]



MIDDLE DISTILLATE STOCKS

	1975	1976	1977	1978	1979
JANUARY	199,715	165,428	142,975	213,411	164,963 P
FEBRUARY	176,696	150,439	133,246	165,830	127,082 P
MARCH	161,111	138,306	141,876	137,877	113,340 P
APRIL	146,214	137,249	148,223	136,240	116,530*
MAY	152,027	147,057	162,222	145,046	125,642*
JUNE	163,306	165,064	178,635	157,515	
JULY	181,472	190,661	204,875	180,513	
AUGUST	197,323	217,930	229,783	200,351	
SEPTEMBER	220,732	232,230	252,783	220,794	
OCTOBER	226,113	235,599	267,392	233,066	
NOVEMBER	235,749	223,648	270,571	233,207	
DECEMBER	208,787	185,948	250,260	216,367	

WEEK ENDING:

JUN 1, 1979	125,642*
JUN 8, 1979	126,225*
JUN 15, 1979	128,525*

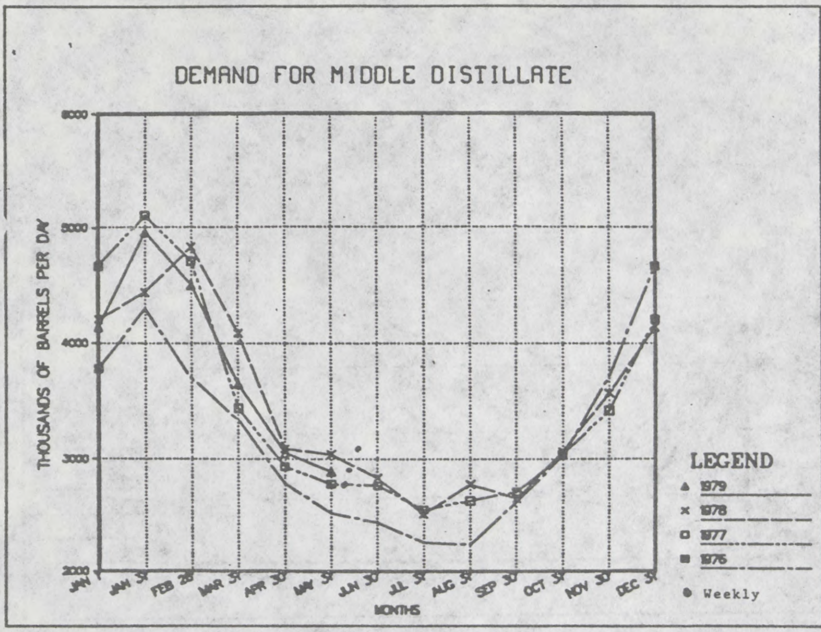
SOURCE DATA: BOM/DOE PETROLEUM STATEMENT, MONTHLY, EXCEPT AS FOLLOWS:

P= PRELIMINARY DOE STATISTICS

*= BASED ON API STATISTICS, TO BE REPLACED WITH DOE DATA AS AVAILABLE

R= REVISED

EXHIBIT A



DEMAND FOR MIDDLE DISTILLATE

	1975	1976	1977	1978	1979
JANUARY	3,953	4,297	5,103	4,439	4,959 P
FEBRUARY	3,803	3,697	4,703	4,831	4,501 P
MARCH	3,293	3,339	3,442	4,089	3,650 P
APRIL	3,094	2,788	2,936	3,092	3,049*
MAY	2,382	2,519	2,782	3,044	2,888*
JUNE	2,266	2,436	2,770	2,837	
JULY	2,112	2,255	2,550	2,514	
AUGUST	2,173	2,237	2,632	2,779	
SEPTEMBER	2,163	2,620	2,714	2,653	
OCTOBER	2,675	3,031	3,037	3,068	
NOVEMBER	2,544	3,714	3,421	3,568	
DECEMBER	3,778	4,667	4,205	4,135	

WEEK ENDING:	
JUN 1, 1979	2,781*
JUN 8, 1979	2,971*
JUN 15, 1979	3,185*

SOURCE DATA: BOM/DOE PETROLEUM STATEMENT, MONTHLY, EXCEPT AS FOLLOWS:

P= PRELIMINARY DOE STATISTICS

*= BASED ON API STATISTICS. TO BE REPLACED WITH DOE DATA AS AVAILABLE

R= REVISED

EXHIBIT C

AtlanticRichfieldCompany

Products Division
515 South Flower Street
Mailing Address: Box 2679 - T.A.
Los Angeles, California 90051
Telephone 213 486 3210

N. M. Smirlock
Manager
Government Controls Coordination

April 12, 1979

New England Congressional Caucus
53 D Street, S.E.
Washington, D.C. 20003

Gentlemen:

We would like to respond to your letter of March 16, 1979 directed to Mr. Hollis M. Dole of our company relating to heating oil supplies and prices. Prior to providing specific answers to the questions listed in your letter, we believe several comments should be made concerning the present supply/demand situation.

First of all, even without the Iranian disruption, the inordinate growth in domestic demand and certain constraints on U.S. refinery operations already had contributed to a tight supply condition. The Iranian disruption only served to make matters worse.

For the first time in the history of the United States demand for all petroleum products exceeded 21 million barrels per day in January 1979. Not only is this figure remarkable, but it is a counterseasonal occurence which is even more disturbing. This level of demand is well above the industry's refinery capacity of 17-18 million barrels per day. Even though the refining sector operated at 93 percent of capacity (at or near the maximum sustainable rate) during the fourth quarter of 1978, it was not sufficient to prevent tremendous drawdowns of product inventory or increased imports.

Distillates have experienced record demand. As you are well aware, we have had three successive cold winters which, along with economic growth, have increased distillate consumption by 20 percent since the beginning of 1976.

Distillate cannot be looked at in isolation. Gasoline demand has also increased at alarming rates. To illustrate, gasoline demand in PADS I-IV showed an increase of 4.7% for the first two months of this year as compared to the same period a year ago. In the West, the increase was much more dramatic reaching a level of 8.9% over last year in the face of high demand, the refining industry has also had to contend with supply constraints resulting from the following federal mandates:

- o Various forms of price controls since 1971. These have acted as a disincentive for refiners to make investments in refinery modernization or expansion.

- o The ban on MMT and lead phasedown regulations. These have reduced the amount of gasoline refiners could produce.

- o Unleaded gasoline requirements. These have also resulted in less overall production of gasoline.

Thus, we are concerned that too narrow a focus on Iran will inhibit recognition of other equally relevant factors mentioned in this letter. A comment is also in order relative to worldwide crude oil supplies. Given a single free-world market for crude oil, particularly incremental supplies, the relevant figure is the 2.8 million barrels per day shortfall in worldwide crude production during September through January, not the normal 500-600 thousand barrels per day of Iranian imports by U.S. firms.

Although Iranian wells have started to flow again, their production is well below the pre-shutdown level of 6 million barrels per day. In response to this continued restriction in worldwide crude supplies, unabated increased consumption of petroleum products by the American public, and the domestic supply constraints previously enumerated, Atlantic Richfield has found it necessary to allocate gasoline to its customers. In addition, we have implemented volume control programs for distillate and have asked our jet fuel customers to cooperate with us voluntarily to reduce demand.

While admittedly unpopular, these steps are necessary to build gasoline stocks for the coming summer driving season and to replenish distillate stocks as early as possible in order to meet demand during the 1979-80 heating season.

Atlantic Richfield Company has been continuously adjusting its refinery and supply operations to meet our contractual commitments. Starting last summer, we initiated a program to supplement refinery production with purchases of distillate. To date, we have purchased over 150 million gallons of product. The prices for these spot purchases have exceeded our average distillate sales prices. In addition, we moved to a maximum distillate operation in our refineries in February. This resulted in an additional 40 million gallons of distillate production at the expense of gasoline.

In order to replenish gasoline inventories, we have purchased over 100 million gallons of gasoline at prices exceeding our current average sales prices. We have also moved product from the West Coast to the East to balance the supply situation.

In addition to the above actions, which have added to our costs, OPEC has of course raised their prices for crude oil. With the cutback in Iran, prices for foreign crude have escalated with some spot purchases over $20.00 per barrel.

Thus, the higher prices for distillate reflect the severe upward pressure in the marketplace due to increases in demand, cutback in crude avails and significantly higher costs.

With respect to your specific questions, you correctly pointed out that the data requested are considered proprietary. More importantly, many questions would call for disclosure of information which is competitively sensitive. Thus, we are not declining to respond simply because of the proprietary nature of the answers, but because disclosure to competitors could cause serious economic harm, and would be at odds with the principles of competition underlying the anti-trust laws. As we understand your organization, even if we were given assurances of confidentiality, there is no basis upon which the data could be protected from discovery.

Very truly yours,

ATLANTIC RICHFIELD COMPANY

N M Smirlock

N. M. Smirlock
Manager
Governmental Controls Coordination

EXHIBIT I

ATLANTIC RICHFIELD COMPANY

Medium Distillate Inventory (1)

Padds I-IV

MBbls. End-of-Month Inventory	ARCO 1976-77	1977-78	1978-79 (2)
September	11372	10633	
October	12200	11109	
November	10898	11585	
December	7978	9642	
January	5690	6879	
February	5074	4920	
March	5558	4136	
April	6335	4331	

Note: (1) Purchases were sometimes required to achieve these inventory levels.

(2) Disclosure of these data would be anti-competitive.

Mr. MOFFETT. It is indisputable, isn't it, that Arco is pushing at least this year's inventory level back a month, and given that fact, don't we face a potential home heating shortage in November–December, if the weather is unusually cold or abnormally cold in those months?

Mr. WAGNER. With an inventory level growing from 9.9 to 10.4 at the end of the year—let me check that number.

Mr. MOFFETT. Yes.

Mr. WAGNER. Yes, 10.4. And producing the amount that we are, we would not see in our case any problem with supplying our customers in November and December.

Mr. MOFFETT. Besides the weather you have to consider that the dealers' secondary and tertiary levels will be low. The Arco contract level is 80 percent of last year's and those contracts have a 70-percent allocation fraction until September. Isn't that right?

Mr. WAGNER. We are renewing the contracts at what has been on the average what the dealers have taken from us. In the previous contracts that we have had, on average over the heating season, over the year, dealers only took 80 percent of the contract. We have renewed the contracts then, at that 80 percent of the maximum level and we, as I pointed out to you, are prepared to supply that contract level beginning September 1.

Therefore, we believe then, that on the average our resellers who have contract with us—and that is essentially all of our business—will receive the same amount as they got in previous years.

Mr. MOFFETT. But the dealers who did not meet the minimum, for them it is too bad. Is that right?

Mr. WAGNER. As I pointed out in my prepared testimony, where people have not taken maximum contract, that is, the minimum amount of the contract in the past, we have not renewed those contracts.

Mr. MOFFETT. How many consumers would those people serve?

Mr. WAGNER. I do not have knowledge as to how many contracts that is.

Mr. MOFFETT. Let me make this point. For those dealers it is too bad, and for the people they serve, it is too bad if they cannot find other products; right? That is a fact isn't it?

Mr. WAGNER. I am sure you are aware of this, Mr. Chairman. Most resellers have more than one supplier.

If they elected not to buy from us and took less than the minimum of the contract, we assume or have to assume that they had some other arrangement to get supply and they no longer needed our contract.

Mr. MOFFETT. So the contract who bought, let's say, only 65 percent of their contract minimum last year is terminated. Is that right?

Mr. WAGNER. Yes, those contracts——

Mr. MOFFETT. You may consider it a reasonable business decision. You obviously are doing what comes naturally, but the fact of the matter is that that leaves the dealer in a precarious situation. Perhaps it is not your burden, but that fact has to be established.

Mr. WAGNER. May I point out one other thing to you?

This methodology, if you will, that is, the contracts in doing this this way come to this. It seems to me that this is a great help in doing it this way.

We know how much we are obligated to supply through a contractual arrangement.

We, therefore, have made our plans to supply that volume. That is why I mention to you that we are going out and we are prepared to go out and buy crude oil to supply that volume.

It makes it available then at the terminal when it is needed. The resellers and distributors of heating oil who are Arco's customers then know that they have a supply which we will supply to them.

Mr. Moffett. The Chair now yields to the gentleman from Massachusetts, Mr. Drinan.

Mr. Drinan. Mr. Tebo, I find your testimony very unsatisfactory. You suggest that the normal processes of the industry can minimize if not eliminate this problem. That is not supported by any evidence.

You go on to say "We do not need State or Federal agencies to interfere with the day-to-day distribution." You are telling us in other words that there have been mistakes at DOE, and we all admit that, but you are telling us, the politicians, to get out of your life and don't interfere. Obviously, the present crisis with long gas lines does not give the American people any trust in Cities Service or any of the companies.

Today we are going to put a very heavy excess profits tax on the oil industry and yet you sit here and say "Don't do anything even at the State level, don't cooperate, or don't try to have a plan." Why don't you people work with the Massachusetts Department of Energy and work out a plan so that come January and February in the blizzards, at least the old ladies will know they will get 85 or 90 percent, and we will not have chaos and long lines.

I see you people resisting and defying every rational attempt at the State and Federal level to, as you put it, interfere with your business.

You blame it all on the politicians. We want to be constructive. Why don't you people form a regional group in New England, in Massachusetts, to collaborate and propose some plan so that the people will know what to expect.

Mr. Tebo. First, we do cooperate with the Massachusetts State Energy Office. We have for years. I think if you asked those people they would tell you that.

Mr. Drinan. They did not say that 2 days ago. They say it is total chaos. They have long lines and no one knows where the gas has gone. So the collaboration has not worked out.

Mr. Tebo. That may be, but the other thing I would mention to you is this. All the regulations that you put on do not add one drop to the supply.

I am suggesting that the companies will sell the product into the State at a level with or without the State energy offices telling them where.

We happen to be on a 50-percent allocation right now. I understand as I was leaving the office yesterday to come here—I do not have all the facts—that we were assigned to some railroad accounts by the State or DOE—I do not know which—with whom we have never done business before. I do not think that is the proper way to handle the customers who depend on Cities Service for their supply.

We have contracts, and we are going to put it into the State at the same levels that we have before. We are going to be equitable. Now, my problem is when the State offices do things like I just suggested to you. We will get it to our customers to the best of our ability. The problem you are talking about here today with Cities and anybody else, supplywise, it is strictly a matter that we do not have the crude oil to run. If we have that, we would be in better shape.

I suggested one way that we could supply the customers in New England a higher amount of heating oil and that is to give us back the 8,000 barrels a day that is going to small refiners by congressional direction.

Mr. Drinan. I noted that point. I do not know how much it would help the people of Massachusetts.

My point is this. Now we have a standoff between Cities Service and the oil companies on the one hand, and every person in the Federal Government who is trying to tell or to prepare a blueprint for the winter on the other. I am asking for your cooperation. We want you to say that 85 percent will be available. Please don't hoard. Please don't do all types of things. Please don't panic. Otherwise the people will blame it on the Government, but you want them to blame it on the Government. That is the whole thrust of your testimony.

I am the first one to say that DOE has made all types of mistakes, but all I can say is this. The reputation of the oil companies come this spring will be worse than it is now.

I think it is preventable.

Mr. Tebo. We have told our customers what to expect from us. We got them together. We outlined the plans for the year.

Whether the State energy office has that information, I do not know. Maybe we should communicate with them.

Mr. Drinan. That is precisely what I am suggesting.

Mr. Tebo. I would be happy to.

Mr. Drinan. When will it happen? Tomorrow?

Mr. Tebo. Sure.

Mr. Drinan. I have to face people for the next week at home. They will blame everything on Cities Service and on the politicians. All I can say is that together the officials and the oil companies could draw up a blueprint so that some people might have a little bit of faith in the Government working with the private sector.

Mr. Tebo. I agree with that 100 percent.

Mr. Drinan. You did not say that in your testimony. You said in your testimony that the State and Federal Governments should get out and should not interfere in any way with the business. You did not say that.

Mr. Tebo. I did not say "any way in the business." I said in the day-to-day distribution.

Mr. Drinan. That is the business.

Mr. Tebo. Day-to-day.

Mr. Drinan. I am concerned about the day-to-day distribution and you tell us to get out. You don't want any State or Federal regulations. That is what you said. You can contradict it if you like. I would be pleased if you want to contradict your own testimony.

Mr. Tebo. Comment for me on the special rule 9 which gave the people——

Mr. Drinan. Of course it is a fiasco. We know it is a fiasco. There will be other fiascos.

Mr. Tebo. I am suggesting to you that the home heating people in New England would have been much better off without special rule 9 as far as Cities is concerned.

Mr. Drinan. All I am saying is that you people should collaborate with every relevant agency so that more special 9 fiascos don't happen.

I yield back the balance of my time. Mr. Chairman.

Mr. Moffett. The Chair recognizes the gentleman from Indiana, Mr. Sharp.

Mr. Sharp. Mr. Wagner, I believe that you suggested in your testimony that the Department of Energy's goal of 240 million barrels in terms of stocks by October was perhaps unnecessary and would be high as a goal.

Am I correct in that restatement? I wonder if Mr. Tebo agrees with that?

Mr. Tebo. It has been reported by DOE that there is some cushion in it.

Our portion of the 240 million barrels is not excessive. We have been there traditionally. I think that DOE looked at us a little differently because we had had a disproportionate share of our problems with foreign crude oil.

Our share was not excessive, but I think the 240 million barrels is excessively high. We do not need that much.

Mr. Sharp. I have heard some criticism in recent days from other parties suggesting that perhaps it was low and it is very difficult for us to get an assessment of what to expect next winter. I am sure everybody on all sides of the question has the same difficulty.

Let me ask you this in terms of the immediate future.

I will follow up what Mr. Gore said. As we get into the harvest season, what do you expect to happen and will it be necessary to have this? I understand you argue against special rule 9. There are complications in the distribution. I understand that.

However, are we going to have a situation where, if we are going to harvest the crops, we are going to have to return to an allocation that takes care of the current need that gives a higher priority to the agricultural community during that period and risk what may come later?

Let me ask in conjunction with this another question. Help me understand the extent to which you supply the agricultural sector.

Mr. Tebo. In Cities Service's case we supply very little diesel fuel. I think it was 12 percent of our total distillate output that goes into diesel fuel. We have been committed to the home heating business.

My answer to the harvest situation is that we will continue to sell the people we have sold in the past.

I mentioned in my prepared testimony that we voluntarily went on the plan to allocate those people at a higher level than the home heating business.

Left alone, we would have gotten that done. But we were not left alone. We had special rule 9 and that gave people license to come in and certify ridiculous amounts.

Mr. SHARP. Do you think, therefore, that there may be some diesel fuel out there in secondary and tertiary storage picked up by people as a result of the agricultural priority which will we see on the market later in the year?

Mr. TEBO. That is a possibility. I am not sure of that at all. I do think there is some home heating oil in secondary storage above what we think there is. I am not sure about diesel.

Mr. SHARP. Mr. Wagner?

Mr. WAGNER. Mr. Sharp, in the East where we market middle distillates, most of it is in the home heating oil market. That is the largest share by far.

Our major participation in the agriculture market is in the volumes that we sell in California which are also very tight out there.

Our perception is that we will get through this season in both the agricultural and, of course, the irrigation market goes along with it.

Mr. SHARP. Is it your general impression from your knowledge of the entire oil situation, more than just of your own companies and assuming that you attempt to keep up on that, that we are going to get through? Do you argue that we can get through without this special rule 9? Do you think other firms can get by without that?

Mr. TEBO. I am arguing that we cannot get by unless special rule 9 is eliminated and others like it.

Mr. SHARP. Both of you testified that among the rules that you think interfered was the requirement to sell to those who do not have fuel. I assume this refers to refineries that do not have their own supply of crude and therefore some of your crude has been taken away.

I can understand your point of view on that. We have not heard from the other side. I suspect their attitude is radically different from yours.

I would like to see you elaborate and explain the loss of efficiency in terms of the entire country, not just in terms of your particular given system.

Mr. TEBO. I would suggest that in our case the 8,000 barrels a day that I testified about go to refineries who have hardware in their refinery which are kind of thrown together and do not produce the high consumer products, high yields that we produce.

They produce heavy oils. They produce asphalts.

Our refinery does not produce any of those things if it is operating properly.

What has happened to those barrels of oil that get transferred to the smaller refiners is that the products that are made are not the ones that are in short supply.

We will make gasoline and distillate out of it, and they will make heavy oils and asphalts out of it.

Mr. WAGNER. Mr. Sharp, I think I have a slightly different position. I do not think we are concerned with the small refiner because we recognize that certainly in the crude market today it is an extremely difficult place.

However, the thought that I expressed in the comments that I made earlier are directed more at our having to supply major refiners with crude oil.

It seems to me that anybody who is a 175,000-barrel-a-day refiner is a big enough boy to be able to get out and buy crude himself. He does not have to buy it from another company through the mechanism of the Federal Government.

Mr. SHARP. Can you give me some appreciation for how much of that has been going on in terms of keeping the big boys in?

Mr. WAGNER. We are supplying 65,000 barrels a day, as I pointed out earlier, this is to major refiners. These are under contracts which have expired but which are only enforced because of the rules and regulations that we are under.

Mr. SHARP. Let me change the subject a moment to the question of why we had such a drawdown in stocks in this country over the last year. You addressed that in part, I believe, Mr. Wagner. I am interested in two parts.

I would like to know to what degree you are into production of domestic fuels and did your domestic production, that is, your production of crude oil, did it decline last year and was that abnormal? There has been an implication that we had a decline in domestic production of nearly half a million barrels a day which is abnormal, that is, between October and March of this year. It has been said that this in part contributed as much as did the international situation to the condition we have now.

Can you give us some appreciation about the central thesis of the decline in domestic production and to what degree you are involved in domestic production and did your domestic production decline?

Mr. WAGNER. I do not think I have any numbers on the tip of my tongue to quote for that answer. I do know that domestic production in the lower 48 States, as it has been for a number of years, has been declining at a very steady rate. I think I have heard numbers of 5 to 8 percent. I guess I would not dispute those, though I do not know them specifically.

In our particular case, however, inasmuch as we have such a large volume of oil flowing from the North Slope of Alaska now, and inasmuch as that has tended to increase a little bit over the past year, we have been more affected by that which has tended to maintain our production supplies rather than seeing a dropoff that maybe other people have had.

Mr. GORE. Will the gentleman yield?

Mr. SHARP. Let me get Mr. Tebo to answer that question.

Mr. GORE. Excuse me. The reason I was going to ask you to yield is that I do not think we really got the answer that I think the gentleman's question deserves. In the 48 States during the first 4 months of this year did Arco's production decline significantly or otherwise?

Mr. WAGNER. I do not know that.

Mr. GORE. You are the vice president in charge of volumes management.

Mr. WAGNER. I am not a crude oil man. I do not know what the Arco Oil & Gas Co. which is the domestic production end——

Mr. GORE. But that is your principal source for refining products, isn't it?

Mr. WAGNER. Mr. Gore, I am not trying to evade. I can get you the information. I do not know if off the top of my head.

Mr. GORE. That will be fine.

Mr. MOFFETT. Without objection, the record will remain open at this point for the purpose of inserting this additional information.

[The material follows:]

1333 New Hampshire Avenue, N.W.
Suite 1001
Washington, D.C. 20036
Telephone 202 457 6219

AtlanticRichfieldCompany

Edward D. Griffith
Director
Federal Government Relations

August 15, 1979

The Honorable Toby Moffett, Chairman
Subcommittee on Environment,
Energy and Natural Resources
House of Representatives
B-371B Rayburn House Office Building
Washington, D. C. 20515

Dear Mr. Moffett:

On June 28, 1979, Mr. Edward F. Wagner, Vice President and Manager of Volume Management for ARCO Petroleum Products Company, a Division of Atlantic Richfield Company appeared as a witness at the Joint Subcommittee hearings regarding the price and supply of diesel and home heating oil. Mr. Wagner was requested to provide information for the hearing record pertaining to the central thesis of the decline in domestic production and the degree ARCO oil and Gas Company, a Division of Atlantic Richfield Company, production declined from last October through April of this year. This letter is in response to the Subcommittees' request.

<u>ARCO Oil and Gas Company Production</u>

As shown on the attached Exhibit I, ARCO Oil and Gas Company's production in the South 48 states has been in a gradual decline for a considerable period of time. For the specific period of October, 1978 through April, 1979, our production rate has declined from 263,000 barrels per day to 248,000 barrels per day, a decline of 15,000 barrels per day.

We experienced a very significant decline in February of some 11,000 barrels per day from the January rate. This decline was the direct result of weather (unusually heavy rains in California causing operational problems), property sales (part of our interest in the Long Beach Unit), and mechanical problems (our key South Pass Block 61 field experienced compressor problems). Once these conditions were corrected, production returned to the normal level in March, April and May.

While our South 48 states production has been gradually declining, our total domestic production has remained essentially constant at almost 488,000 barrels per day since December, 1978. Again, February was a notable exception in which we experienced a production decline of some 26,000 barrels per day. This severe decline was the result of the above South 48 sates problems further compounded by severe storms in the Gulf of Valdez. These storms forced the reduction of the TAPS throughput from 1.2 million barrels per day to an average of 484,000 barrels per day for three days (February 7-9, 1979) due to reduced tanker operations causing storage problems at Valdez. Here again, with the return of better weather conditions, our production returned to a normal level.

Industry Production

The attached Exhibit II shows industry production for 1977 through 1979 based on data from the Energy Information Agency's July Monthly Energy Review. In addition, we have plotted the data which was available in the May Monthly Energy Review which created much of the concern. It is apparent from the revised data that the decline during this period was not as severe as indicated by the early production estimates. It is normal to see some steepening of the decline rate during winter months and the winter of 1979 had some unusually harsh days in the major producing regions. Representatives of the regulatory agencies in the primary producing states of Texas, Oklahoma and Louisiana have indicated the January weather was the worst in almost 30 years and necessitated some abnormal winter shutdowns. Once the weather returned to normal, production did also as indicated by the February rate for the South 48 states.

Although production from the South 48 states rebounded in February, the total domestic production for February did not show substantial gains due to the storms in the Gulf of Valdez. These storms caused the average production rate from the North Slope to be reduced from 1.2 million barrels per day in January to 1.1 million barrels per day in February. The March and April rates were back at 1.2 million barrels per day rate.

The statistical discrepancy which caused much of the concern regarding an abnormal decline in domestic production has been an inherent part of past records. This discrepancy is due to the different sources of data utilized to obtain the very latest estimate of production. In each Monthly Energy Review, the latest month's data is obtained from the API weekly production reports and this tends to be slightly high (50,000 B/D) relative to the final figures. The prior 2 months' estimates are based on the Energy Information Agency's first purchaser reports which tend to be low (about 200,000 B/D). The fourth month prior is based on the EIA's monthly petroleum statement which is taken from the various state agencies data and is the most reliable report of production data--although it too is subject to further revision. Consequently, there has been a characteristic swing in the data of about 250,000 B/D. This problem was becoming very acute and actually reached a peak with the May Monthly Energy Review. We understand that the EIA has subsequently altered their statistical procedures to attempt to improve early production reports and the July report appears to be much more reasonable. Hopefully, these revised procedures will prevent any future confusion regarding production declines.

Atlantic Richfield Company sincerely appreciates this opportunity to provide this clarifying information regarding the decline of domestic production for the hearing record.

Sincerely yours,

Edward D. Griffith

Edward D. Griffith

EDG:fa

Attachments

Exhibit I - Crude and Condensate Production
ARCO Oil and Gas Company
Divison of Atlantic Richfield Company

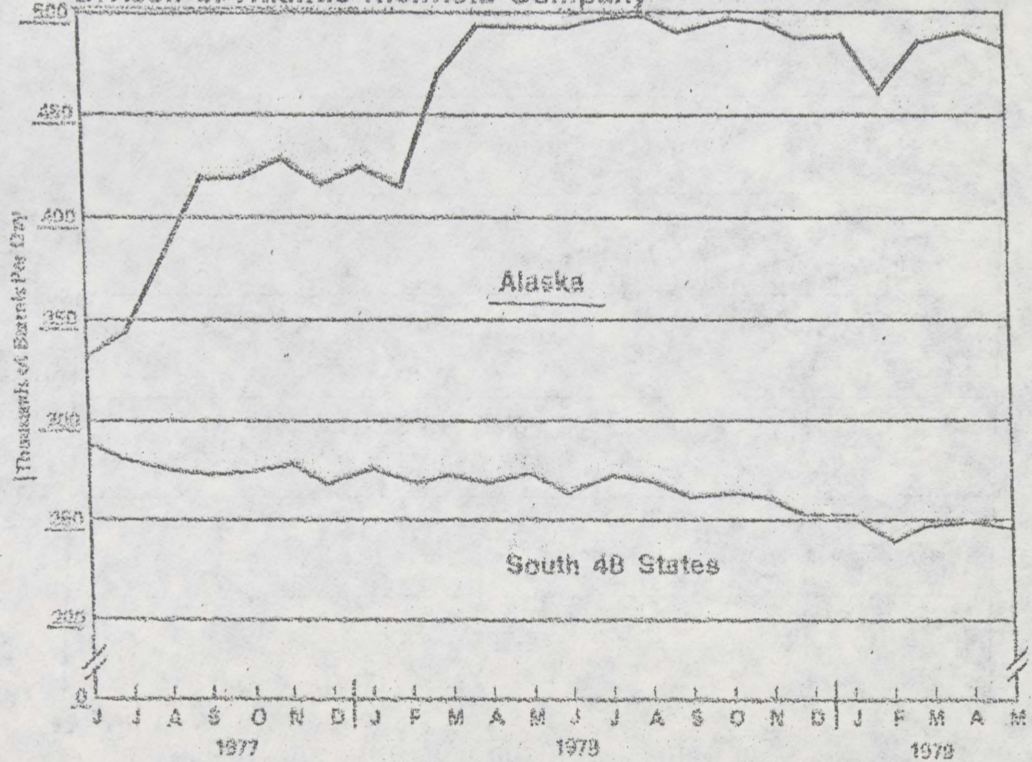
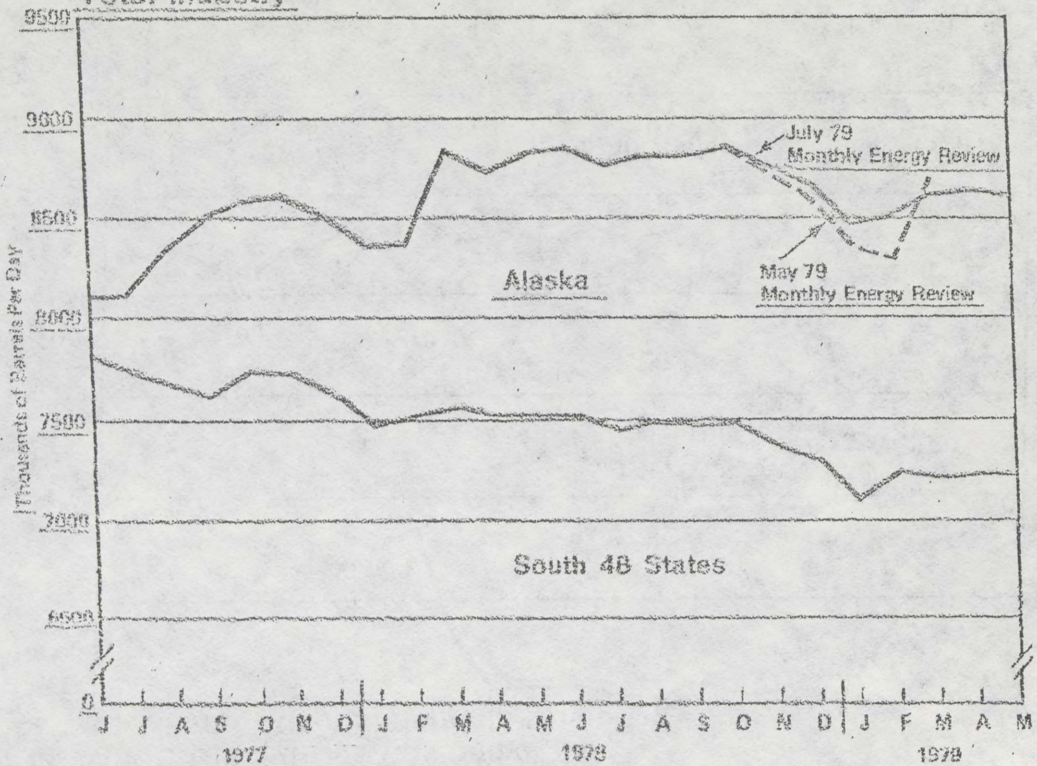


Exhibit II - Crude and Condensate Production
Total Industry



Mr. SHARP. Mr. Wagner, we appreciate your supplying that.

Mr. WAGNER. Do you want it in the lower 48 States?

Mr. SHARP. Yes.

Mr. Tebo?

Mr. TEBO. Unfortunately, in our position our own crude oil production is not the major supplier of crude oil to our refineries. I believe that we produce something in the vicinity of 90,000 barrels a day, and we run almost 300,000 barrels a day.

So unfortunately, we do not produce nearly as much as we refine ourselves.

I do not have the answer to your question either. It is not my line of business.

I would suggest that Cities Service's domestic crude oil production has declined every year for the past 5 or 6 that I am aware of. I assume it did.

Yet, on the other hand, we are spending record amounts of capital to find new crude. We just have not come up with that big strike yet. It is not because of lack of effort or funds.

Mr. SHARP. I appreciate that. I do not doubt that lots of money is being spent. I do not doubt that you have a long-term interest in that, but the allegation has been made. We continually get asked about it. We will be asked more intensively about it. The Justice Department is investigating it.

The allegation is that there was an abnormal decline in U.S. production. It may have been temporary. It may have been in some places the result of abnormally wet or cold weather that reduced production, but the implication that some people make is that in fact it was rather geared to the present tight market situation and therefore gave some price boosts and some additional revenue in the end over the long term to those that are in that production. It is one of those kinds of suspicions that undermine your position, and undermines the U.S. position as it fails to be able to explain these things.

That is why I think it would be helpful if you and others in the industry can help us get solid informtion as to what is the case and if there has been an abnormal decline, what is its explanation.

I don't mean to lecture you. You have been hearing plenty of lectures from your neighbors and friends, I suspect.

However, it is very clear that there is enormous distrust. Every hearing that comes up, you ask us to drop Government regulations. We see that many, many times the Government regulations are just counterproductive. They do not do what they want, but there is the risk to be taken of dropping those regulations and to dropping the oversight of the industry and that could not be taken if the deep suspicions last.

Mr. TEBO. Yes; I understand that.

Mr. MOFFETT. The time of the gentleman has expired.

Mr. SHARP. Thank you, Mr. Chairman.

Mr. MOFFETT. We would like to have that information requested earlier. This would be helpful not only to the subcommittee but it seems like you gentlemen would want to know that. Does that not relate to your job?

Mr. WAGNER. Yes; it does.

Mr. TEBO. I read the same article Mr. Sharp was referring to.

Mr. Moffett. Not only for public relations purposes but it seems like you would want to know that anyway, wouldn't you?

Mr. Wagner. Yes.

Mr. Moffett. Is it irrelevant?

Mr. Tebo. It is not irrelevant.

Mr. Wagner. It is not irrelevant.

But in the way that my particular sphere of responsibilities go and the way we see it, if it does not come from the domestic producing company, then we go out and buy it. That is what we have done.

Mr. Moffett. The Chair recognizes the gentleman from Minnesota, Mr. Stangeland.

Mr. Stangeland. Gentlemen, let me follow up on what Mr. Sharp was asking about. Is it the same DOE regulation that requires you, Mr. Tebo, to sell 8,000 barrels to the small refiners and the 65,000 barrels that you speak of, Mr. Wagner? Is that the same DOE regulation?

Mr. Tebo. I believe it is; yes.

Mr. Wagner. Yes; I believe they come under the same general area.

Mr. Stangeland. Are there any of the small refiners, Mr. Tebo, that you know who would be refining middle distillates and gasoline of that crude that you sell them?

Mr. Tebo. I am sure they do. I am just suggesting that when the full 8,000 barrels gets put into the marketplace we would have done a much better job with it in gasoline and distillates.

Mr. Stangeland. What kind of a markup can you get on that crude? Are you able to buy crude to refine at the OPEC price, let's say, and perhaps buy on the spot market? Which oil are you required to sell to these refiners, or can you sell them either oil? What kind of markup do you experience?

For those refiners who are buying from particularly Arco, Mr. Wagner, what can they charge for their end product as opposed to what you charge for your end product? There have to be some markups in here and there have to be some middlemen profits.

Mr. Wagner. We sell that oil to other refiners at our average foreign crude oil price.

In the present situation where we are it makes it so we have to replace that oil with high price foreign crude oil, then that additional cost between the average that is sold at versus what we buy it at obviously goes into our raw material costs.

Mr. Stangeland. Would their end product cost as a result be higher than your end product cost?

Mr. Wagner. They use the average price rather than the cost to replace it. Therefore, our customers, if you want to look at it this way, are helping to subsidize that sale. We believe that is unfair.

Mr. Stangeland. Is not your end product price based on a blend price of what you have to pay for your product?

Mr. Wagner. That is true, but if we sell, let's say, at $15 a barrel—and that is our average foreign cost—and it costs us $20 to replace it, therefore, $5 is going into our product cost which our customers are being asked to absorb.

Mr. STANGELAND. You recommend that this regulation should be done away with. That is, that you should not be required under this regulation to do these things.

Mr. WAGNER. Let me make sure you understand this. Our position is that there is certainly a question in our minds that major refiners do not need this protection.

Small refiners, we believe, probably do because of the inability to buy raw material, but major refiners; no.

Mr. STANGELAND. Suppose we did away with the regulation and that we required the other major refiners to get into the market to compete. What effect could that have on the market if they were then competing with you rather than having one single purchasing agent which in turn resells to other refiners? What impact would that have on the market?

Mr. WAGNER. There would now be more buyers in the market. That is what you are getting at.

Mr. STANGELAND. Yes.

Mr. WAGNER. I do not think the problem is that great, especially with major refiners out there.

Mr. STANGELAND. Demand and competition tend to drive the price up, wouldn't that be so?

Mr. WAGNER. People that are in a particular market; yes. But the volume is being bought now anyway.

Mr. STANGELAND. The volume is the same, but it does lend the possibility of competition.

You are one of the few major refiners that can operate at 85 percent. That is above 85 percent. You indicate that you are operating at 95 percent and can reach 98 percent. Why is it that Arco can operate at this level and other refiners apparently either cannot or will not do so?

Mr. WAGNER. Because as I indicated to you in my opening remarks that we have gone into the crude oil market and we have paid premiums for crude oil.

It is reflected in our costs and in the prices that we have to charge for the product. We have felt the responsibility to supply our customers and the customers by their demands have really voted to us that that is what they want us to do.

That is what we have done.

Mr. STANGELAND. Mr. Tebo, according to your testimony on page 7 you indicate that rule 9 was abused apparently to the tune of from 15 to 20 million gallons from your company alone. You disallowed the obvious violators.

Can you identify some of those violators and did DOE give any reason for not going after and penalizing those violators?

Mr. TEBO. We visited with the DOE about this subject. They indicated to us that wherever we felt it was being violated we should converse with the local DOE, or regional DOE offices, and we are doing this.

I testified that about 20 million gallons was sold than would have been without special rule 9. I am not suggesting that all 20 million gallons was fraudulently certified, but we are very sure that some of it was.

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It is hard for us to believe that a man that we sold year after year at a certain level that as soon as a law is passed his demand goes up 10, 15, or 20 percent. That leads to some suspicion.

Mr. STANGELAND. I have one last question for you gentlemen. If we were to get some product, that is, if we could come to some kind of arrangement or agreement with our neighboring countries of Canada and Mexico, do you think there is a potential there to create enough product to reduce the reliance on the OPEC countries to put some downward pressure on the price that OPEC is charging? Can we create in the North American Continent enough competition to OPEC to cause some downward pressure?

Mr. TEBO. If any new supply comes on the market, it will have somewhat that effect. That is, to lower the impact and influence OPEC, but I think from everything I have been reading, the Mexican Government has no intention of selling to anyone at less than an OPEC-type price. Therefore, they are in fact a member of OPEC.

The Canadian situation I am not familiar with at all except that our company has spent over half a billion dollars in Canada to build a synthetic fuels plant.

The Canadian Government will not let us export that at this time. It would be to our advantage and to the advantage of our customers if we could.

Mr. STANGELAND. We will be going into deregulation now under the President's order. Today, and in fact right now, we are debating the windfall profits tax. That deregulation is presumed to create more production. Do you anticipate that production is going to be available at less than OPEC prices once deregulation has taken place?

Mr. TEBO. I do not know exactly what prices will be allowed for domestic oil, but I know it will be a lot less than the spot market. I am talking about the crude oil originating in OPEC countries. We hope it is a livable windfall profits tax that is passed today to allow money to be plowed into production that normally it would otherwise not be.

Mr. STANGELAND. Thank you very much, Mr. Chairman.

Mr. MOFFETT. The Chair now recognizes the ranking minority member, the gentleman from California, Mr. McCloskey.

Mr. MCCLOSKEY. Gentlemen, our problem in getting facts distresses me.

I was told several weeks ago when we were going through the gasoline shortage in California that in part it was because the Department of Energy had jawboned the industry last winter to turn out more distillates and less gasoline.

Is that statement correct? Do you know of any request from the Department of Energy that you turn out more distillates and less gasoline?

Mr. WAGNER. In early May at the height of the situation in California, we met with the Department of Energy. That was at the time when they recommended this target of the 240 million barrels of distillate.

Mr. MCCLOSKEY. Is that the first time that target figure was mentioned to your company?

Mr. WAGNER. Yes.

Mr. TEBO. That is correct with us also.

Mr. MCCLOSKEY. When Californians met with the DOE in the height of the gas crisis in May, we understood that it was early January when the Iranian situation occurred. The Department of Energy reached the 240 million barrel reserve figure for next October, it was said. Am I wrong in that assumption?

Mr. WAGNER. That may be when they reached that level, but I was there. That is the first time we saw the number. I think it was reported in the press because they were talking to companies on a sequential basis. We were probably about the 18th company that they talked with.

It was in early May when we finally met with them. They explained to us where they got the number and what they thought Atlantic Richfield's portion of that was.

Mr. MCCLOSKEY. We were told in May by the Department of Energy when we met with them, that is, a bunch of Congressmen, that because of the gasoline shortage at that time in May, particularly because of the California problem, they were asking the refineries to refine more gasoline and more distillates. Is that contrary to your personal experience in your two companies?

Mr. TEBO. The personal experience we had is that signals we get are garbled at best.

To my knowledge, what Mr. Wagner said about the date of early May is the first date that it had been discussed with us about the distillate target figure.

When the gasoline lines formed, we got formed, we got some signals about maximizing gasoline. Then there was the maximization of No. 2 fuel oil. It depends on the day-to-day situation as to what is maximized. That is our problem.

Mr. GORE. Will the gentleman yield?

Mr. MCCLOSKEY. Yes.

Mr. GORE. On March 1, the Department of Energy's tilt regulation went into effect which was a clear signal to maximize gasoline.

There are two types of signals, as the gentleman well knows. There is one that is given on the telephone or in a letter, and there is another one that is given in dollars and cents.

The tilt regulation clearly was the strongest possible signal to maximize gasoline production.

Mr. MCCLOSKEY. Let me ask both of you to comment, if you will, on this relationship between the Government and business. There is the fact that the DOE has the power to force you, if they deem it necessary, to refine one product or another. However, they also jawbone you and try not to exercise that power.

To what extent do either of your companies make decisions based on requests from the Government as opposed—let me put it this way. I take it there are suggestions and there are requests and there are orders.

To what extent can you describe in your personal experiences of the last 6 months about specific examples where your company has reacted to a suggestion, request, or order? Can you give us examples for the record?

Mr. WAGNER. Let's use this one as an example. As I say, in early May we got exposed to the 240-million-barrel figure and to what the Department of Energy's thinking was as far as what Atlantic Richfield's share was.

At that meeting we took with them essentially the same position that I have indicated here today. That is, that we thought it was somewhat of an unrealistic situation and in our particular case, we had already become concerned about the distillate situation as well as the gasoline situation.

We were working along the lines which I have outlined in my testimony here today.

We have not, so far, moved away from that position, nor has the Department of Energy, to my knowledge, indicated to us anything other than that. You are right. We do understand they do have the power under regulation to require a refinery yield program. That so far has not been put in effect.

Mr. McCloskey. They can make a suggestion or a request. In this case you have not reacted.

Mr. Tebo, is that correct with Cities Service?

Mr. Tebo. We paid quite a bit of attention to the jawboning that went on. I will use the same example of the early May request of minimum distillate inventories.

Mr. McCloskey. Let me be brief. You essentially have not responded to their suggestion or request as yet?

Mr. Tebo. We have maximized now the distillate output of our refinery.

Mr. McCloskey. Was that your choice or in response to their suggestion?

Mr. Tebo. I would have to say that it was both, but it was certainly part of their suggestion.

Mr. Moffett. If the gentleman will yield, let me say this. The gentleman is touching on an important point. The subcommittees are concerned about this.

What can you tell us about the Department of Energy's jawboning efforts with regard to you?

Mr. Wagner, from what I gather from your response to Mr. McCloskey's question, you have not heard too much from them in terms of forceful kinds of conversations.

Mr. Wagner. That is correct.

Mr. Moffett. Is that correct?

Mr. Wagner. That is correct.

Mr. Moffett. Mr. Tebo, is that your case too?

Mr. Tebo. In our case, we did use the jawboning as one of the triggering factors to maximize distillate.

Mr. Moffett. You used the jawboning?

Mr. Tebo. Yes.

Mr. Moffett. What does that mean?

Mr. Tebo. It was part of our input.

Mr. Moffett. Give us an example of the jawboning. Does Dr. Schlesinger call up the President of Cities Service, for example?

Mr. Tebo. Not to my knowledge. I think they generally meet with the different department heads or section heads of the DOE.

Mr. Moffett. I yield back to the gentleman for the moment. I appreciate the gentleman's yielding.

Let me say this. This is not your burden, but let me say this for the record. We are hearing from the White House time and time again that the tough jawboning is going on at the highest levels. The gentleman from Tennessee and I were in a meeting the other day and the gentleman from Texas was there. We were told that the jawboning is going on at the highest levels. The fact is that we had suspicions it is not, and it clearly is not.

I thank the gentleman for yielding.

Mr. McCloskey. Let's go back to the question of whether or not you bought on the spot market. DOE told us that in February and March when the spot market was high, the national policy was that we should not encourage OPEC to raise prices following the spot market increases and therefore they jawboned the industry not to buy on the spot market above a certain figure, let's say, $25 or $30 a barrel.

Did either of your companies have a specific experience with the jawboning of DOE in that particular respect about acquiring from the spot market?

Mr. Tebo. I am not absolutely certain, but I believe there was jawboning. I am not absolutely certain.

Mr. McCloskey. Did you follow it or not?

Mr. Tebo. Yes; we did.

Mr. McCloskey. So you declined to buy in the spot market at their request?

Mr. Tebo. Yes.

Mr. McCloskey. That is part of the problem of your lack of crude supplies today is it not?

Mr. Tebo. We declined to buy in the spot market for a lot of reasons. The inability to recover the increased cost was certainly one reason, but we did not go into the spot market until very recently.

Mr. McCloskey. Mr. Wagner?

Mr. Wagner. I had no particular knowledge of that. However, in the discussions I have been privy to, at least, it is hard to pinpoint that we received any direct suggestions. We read about this in newspapers.

As I pointed out in my testimony earlier, we have bought considerable volumes in the spot market.

Mr. McCloskey. Let me ask one final question. I would ask for you to submit a written response to this particular question because I think it is the underlying problem.

DOE tells us they cannot regulate your industry. Mr. O'Leary told us flatly and unequivocally "We do not know how to regulate this finely tuned free enterprise system."

In your testimony you talked about regulation 9, for example, being not just an intrusion but being counterproductive. As we trace these various regulations and the jawboning decisions we find that a month later they may be counterproductive.

There is an understandable desire on the part of the administration to respond to the New Englanders one way on distillates, and to Californians having gas lines with another. It appears that they will change their political direction to the companies from time to time.

On the other hand, if we leave it completely to the free enterprise system to make these decisions based on available supplies, we clearly do not meet the problems that you have mentioned in one of your testimonies about rationing. If the supply is cut, and if the administration says we are going to cut 5 percent by December 1979 in our consumption clearly Government does have a role and a responsibility.

We have to solve this question. Whether the Government does it or the companies do it, it appears that a mixture of the two basically cannot work. It is worse than either of the two doing it.

I would like you to address that question in a written response.

Whether in the situation we face next year you feel it should be all Government, all companies, or some mixture between the two, and if so, how?

I think that is our responsibility in the Congress to resolve. I would like a constructive response.

Mr. MOFFETT. That will be fine.

Without objection, the record will remain open at this point for the purpose of inserting this additional material.

[The material follows:]

It is our view that the Department of Energy has not regulated the petroleum industry effectively in the past. One measure was evident in the gasoline lines that formed in some metropolitan areas while outlying areas had ample supplies. (A principal cause was the allocation system that misdirected supply.) It is also apparent from the frequent changes in direction occasioned not so much by changed conditions as by the mindless imposition of hastily drawn and ill conceived regulations that were counterproductive at best. It is evident from regulations which have precluded rational business decisions and fostered less efficient and most costly operations. These symptoms indicate fundamental weaknesses in the system. First, any national administration is susceptible to political pressure with the obvious result that it does speak of New Englanders and Californians differently. Secondly, given the political environment prevailing today, accepting advice or assistance from individuals in the oil industry, who know the business best, is not acceptable. Therefore, we have politically sensitive, uniformed bureaucracy attempting to solve supply and demand balancing problems in an artifically price constrained market. Obviously, the task is impossible, no one likes the result, band aids are applied to appease the more vocal constituents, and the imbalances become worse.

In spite of recent reports that a number of government investigations have failed to find any evidence of conspiracy, withholding of supply, or other malfeasance by the oil companies, I accept the proposition that some government intervention in the business of petroleum is a political imperative. For this reason, we believe that total decontrol of all oil supply and pricing decisions may be impractical as a short run solution. In the longer term, we believe it is the only solution with a reasonable chance of success. Accepting the premise that some regulation is necessary for the immediate future, we might look at the possibilities.

The distribution system for petroleum products is massive and complex. It involves delicate and rapid-response balancing of supply and demand throughout the nation under conditions that are anything but stable. A temporary shortage of a product in a particular area experienced by one or several refiners is frequently covered by exchanging product with other refiners who have adequate supplies in the area. A shift in demand from one area to another will be compensated for by the industry if government regulations do not make it illegal to do so. It is obvious that companies are better equipped to balance supplies to demand than the government. Therefore, the allocation system should be "all companies". The only exception to this general statement is a condition of serious shortage. A shortage severe enough to require government rationing of available product to prevent civil disorder, and serious threat to the public welfare. Concerns that the companies may direct oil to more profitable products or areas fail to acknowledge that short changing any segment of society can only bring political reprisals of overwhelming dimension. Furthermore, as a practical matter, free market forces will correct any such situation.

The question of price is less clear. Because the price of incremental crude oil is controlled by the OPEC nations and a switch to alternate fuels is both complicated and costly, some modest monitoring of prices by government is desirable for the present. Such monitoring tends to restrain prices and over the longer term will inhibit development of new energy facilities. Therefore, this program too should give way to a return to marketplace economics as rapidly as possible. If we err, it should be on the side on "too soon" rather than "too late".

To summarize, I believe the immediate interest of the American people and the nation can be served best by a combination of government and industry efforts. The companies should be allowed to do what they are in business to do—namely, manufacture and distribute petroleum products in the most cost effective manner to those who need the products. Allocation of products in short supply can be handled most effectively without government intervention. Government monitoring of prices charged is probably appropriate for the short term to assure the public that prices are not unreasonable.

I appreciate the opportunity to express these views. Should you have additional specific questions, I shall be pleased to answer them.

Mr. McCloskey. I do not think we can afford it much longer. We have business hating Government and Government hating business and the people hating all of us. I would like to have your constructive suggestions as to how we resolve that.

Mr. Sharp. I would like a quick followup.

Mr. Moffett. Certainly.

Mr. Sharp. Let me ask you the question of how many or your refiners have been audited by DOE within the last 6 months?

Mr. Tebo. I cannot answer that question. I do not know. I would be happy to provide it.

Mr. Sharp. Would you please do that for the record?

Mr. Tebo. Certainly.

Mr. Moffett. That will be fine.

Without objection, the record will remain open for the purpose of inserting the additional material requested.

The material referred to was not received in time for printing.]

Mr. Sharp. Let me ask you the question of how many of your somebody was at your books, for example, and how many were there? We are not looking at you, but we are looking at the Department. From what we hear, it is supposed to be happening, and we would like to know what is happening out there.

Mr. Wagner, can you respond to that?

Mr. Wagner. Mr. Sharp, I believe the number is correct that there are 18 full-time auditors from the DOE assigned to the Atlantic Richfield Co. They are in an office out there in Los Angeles. They work every day.

Mr. Sharp. You say they are full time? Is that an immediate period of time or are they simply assigned to you forever?

Mr. Wagner. It seems like forever. [Laughter.]

It has been for some period of time.

Mr. Tebo. We have the same situation. I think our number is 13.

You specifically said refineries. I was answering in terms of refineries, but we have auditors on our books every working day of the week.

Mr. Sharp. I see. So DOE does, in fact, have auditors out there examining your pricing and supply situation on a daily basis?

Mr. Tebo. Oh, yes.

Mr. Sharp. I thank the gentleman for yielding.

Mr. McCloskey. Would the gentleman yield for one quick question?

Mr. Moffett. Certainly.

Mr. McCloskey. At the same time this jawboning is going on some companies are under grand jury investigation. I would like to inquire if either of your companies have had any hint that prosecution or lack of prosecution for violation of these complex regulations from the past might play a part depending on whether or not you take certain actions in response to the jawboning?

Mr. Tebo. I have had no indication of that. I do not know.

Mr. McCloskey. Is the prosecution wing in any way connected with their jawboning wing?

Mr. Wagner. I do not know.

Mr. McCloskey. You have had no experience with that?

Mr. Tebo. No.

Mr. Wagner. No.

Mr. McCloskey. The corollary of this question is the complexity of these Government regulations—are they such that honest men could violate the law and be subject to a criminal penalty?

Mr. Wagner. The problem with Government regulations——

Mr. McCloskey. You understood my question. It is yes or no? Are these regulations so complex that honest men can make decisions which are criminal conduct?

Mr. Wagner. I don't think I can answer offhand whether they are criminal or not?

Mr. Tebo. It would have to be a willful violation. Certainly the regulations are hard to interpret and honest men make mistakes in interpreting them. Sometimes the interpretation is made retroactively by the Government. I think it has to be willful before any criminal implication is made.

Mr. McCloskey. Thank you.

Mr. Moffett. Mr. Stangeland?

Mr. Stangeland. Thank you, Mr. Chairman.

Let me follow up, Mr. Tebo, on your discussion about selling to the small refineries.

I understood you to say that you sold the same barrel of oil to the small refiners that you were taking gas and distillate out of and they were manufacturing asphalt and heavy oils. I was always led to believe that the asphalt and heavy oils came from difference parts of the barrel, that is, the part that is left over after the gasoline and distillate were cut out. Or it could be from a cheaper, heavier type of crude.

Can you clarify that somewhat?

Mr. Tebo. Yes; I can. Depending on the type of refinery you have makes the difference as to the kinds of yields that come out of a barrel of crude oil.

A full integrated-type refinery with all of the catcracking and reforming type apparatus does one thing to a barrel of crude oil, and the small refinery that has been thrown together and maybe does 10,000 barrels a day of total product is considerably different. It is mainly a distillation plant that cannot take all the product and divert it to higher use products than can the bigger refinery.

Mr. Stangeland. The small refiner is then producing some gas and some middle distillate as well as the asphalt?

Mr. Tebo. A much smaller percentage out of the barrel than we would do.

Mr. STANGELAND. Would a moratorium on something like asphalt production in any way assist our middle-distillate situation?

Mr. TEBO. I do not know that specifically. I refer to the fact that we should let the people who can refine the crude oil into the best products refine it.

I am afraid if you had an asphalt moratorium, you would have an asphalt strike, and I do not know how you would deal with that.

Mr. STANGELAND. Would you be selling to the small refineries a lower grade, heavier type of crude than what you are normally refining in your own refineries?

Mr. TEBO. It is an agreement between two refineries depending on the configuration or the person that you have to sell to as to what he can use. Generally it seems, at least it is my understanding, that the people we have to sell to need a better quality crude.

Mr. STANGELAND. Thank you.

Mr. MOFFETT. The Chair recognizes for final questions the gentleman from Texas, Mr. Eckhardt.

Mr. ECKHARDT. Mr. Tebo, I was looking at some figures that you can probably explain to me connected with your letter of June 25 to Mr. Bardin. That is Cities Service's letter. It concerns the fraction in distillate and in gasoline.

One is a long, legal-size page headed "Company Profile—Citgo." It indicates in the first column "Distillate Yield Percent."

I find that you have distillate yields starting in January of this year 19.6 and they run up to 21.4 in February. Then there is 19.3 and 18.3, and 21.2, and 18.4, and 21.6, and 19.2, and 20.4, and 20, and 23.6 through December.

I assume this is the percentage distillate yielded from the barrel. Is that correct?

Mr. TEBO. It appears to be. I do not have those figures in front of me. I have never even seen it, I don't think. However, it appears to be correct.

Mr. ECKHARDT. The distillate yield for 1978 in the latter months—and those would be perhaps the most significant because that is when you are building up distillate—ran considerably higher. For instance, in August of 1978 your distillate yield was 28.7 as compared to 1979 of 20.6. In September it was 25 percent compared to 19.2.

In October it was 42 percent compared to 20 percent in 1979. In November of 1978 it was 24.9 percent compared to 20 percent in 1979.

It was 26.8 in December compared to 23.6 in 1979.

Of course, those figures are bound to be prospective, but it would seem to me that you are not really planning to increase your proportionate distillate yield to the extent that you did in 1978. It would appear so from these figures.

Mr. TEBO. I have not seen the figures, so I do not know what you are talking about. However, I would say that the type of crude you process has a big bearing in our case on the percent yield of distillates. That could be the answer.

I am not sure.

However, I do know that we are maximizing fuel oil at the present time or are about to. I believe July 1 is the date when we make the conversion.

Mr. ECKHARDT. Let me point out another attachment to the letter that appears to be an actual refinery report analysis.

It runs through the 15th of June. It averages the distillate fraction for the month of April. It seems to be 18.79 which is not very far from your projected figure.

I assume what I read to you first was the projected figures and the figures I have here now are actual.

The projected figure would have been 18.3, so that would have been a little bit better from what you actually ran.

In May, however, the average figure for each of the weeks was 16.17 as compared to a projected figure on the first sheet I read you of 18.

In June it would be approximately 19 percent as compared to a projected figure of approximately 23.

What really startles me is the drop in the distillate fraction as indicated in June. On June 1 it was 23.18 percent. June 8 it was 18.6 percent. June 15 it was 16.3 percent.

How could that be explained by a different kind of crude over 3 weeks in June? I assume this is over all of your refineries.

Mr. TEBO. It is plausible that it could change from week to week depending on the type of crude you happen to be running on a certain day. You do not have many days inventory in a refinery. The crude shipments come daily.

I suggest that is why those fractions vary, but I am not certain.

Mr. ECKHARDT. I am suggesting, No. 1, that you seem to be running a smaller percentage of distillate yield and plan for a smaller percentage in 1979 than in 1978. Also the figures that I read from would indicate that your actual distillate fraction is running below your projected distillate fraction.

I know I am catching you on pages that you have not seen, but I suspect that you may have an answer for it if you would look into it more deeply.

Mr. TEBO. I would be happy to.

Mr. ECKHARDT. I would ask you to respond for the record after you have an opportunity to look at these.

Mr. TEBO. I will be happy to do that.

Mr. ECKHARDT. I ask unanimous consent that the record be held open for this material.

Mr. MOFFETT. Without objection, it is so ordered.

[The material follows:]

CITIES SERVICE COMPANY
PETROLEUM PRODUCTS GROUP

CITGO

Box 300
Tulsa, Oklahoma 74102

July 23, 1979

Mr. John R. Galloway, Staff Director
Subcommittee Environment,
Energy and Natural Resources
Committee on Government Operations
U. S. House of Representatives
B 371 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Galloway:

During my testimony before the Moffett Subcommittee, I was asked to respond to Mr. Moffett's question regarding our lower distillate yields in 1979 based on information we had sent to DOE a few days earlier. I could not respond to the questions due to lack of knowledge but agreed to investigate later. Below is the findings of my investigation.

The higher 1978 yields were due to the fact that we were able to acquire large volumes of heavy gas oils (cat cracker feed) from other refiners. This acquisition allowed Cities to divert like quantities of virgin light gas oil from its original use as cat cracker feed directly into No. 2 fuel oil blends.

We have not been able to buy large quantities of that product (cat feed) from other refiners in 1979 at a price we can justify.

For example, in 1978, we purchased 3,750,000 barrels of outside cat feed which yielded 3,193,000 barrels of No. 2 fuel which increased our daily average No. 2 fuel oil production as much as 23,000 barrels per day. In contrast, we have purchased only 841,000 barrels of cat feed so far in 1979.

These circumstances were described in our response to DOE after our session with them in early May when we received our "quota" for off-season inventory. A copy of that response is attached.

At any rate, the outside purchases, or lack of purchases, of a raw material or cat feed is the answer to the question of our yield variance. If cat feed becomes available at prices we can justify without damaging our customers, we most likely would purchase it.

Also attached is a table showing the yield patterns from crude and from the cat feed which graphically points out the impact of no, or little, cat feed.

Sincerely,

C. F. Tebo

C. F. Tebo
Manager of Planning & Analysis

bb
Attachments

CITIES SERVICE COMPANY
BOX 300
TULSA, OKLAHOMA 74102

May 18, 1979

Mr. George E. Hall, Jr.
Director - Fuel Supply and Allocation
Office of Fuels Regulation
Economic Regulatory Administration
Room 6128
2000 M Street, NW
Washington, DC 20461

Dear Mr. Hall:

Cities Service Company submits the following information in response to your questions for refiners which were received at a meeting in ERA offices May 2, 1979.

Question No. 1

What problems do you anticipate in meeting inventory targets on a custody basis or on an ownership basis?

Answer

Cities Service has only incomplete data and no control of "custody" volumes. All responses contained herein, therefore, are based on ownership volumes.

Cities Service would encounter extreme difficulties in meeting a distillate inventory target of 8,400 barrels at October 5 if it were to supply its customers with historic levels of product during the period May through September. Historically, Cities Service's refinery production of distillates has been increased by the purchase of heavy gas oils from other refiners which enabled it to divert like quantities of virgin light gas oil from cat cracker feedstock directly into No. 2 fuel oil blends. In addition, Cities Service's distillate supply was augmented by significant purchases of finished product. In 1978, for example, Cities Service purchased 2,913M barrels of cat cracker feedstocks and 2,570M barrels of No. 2 fuel during the May-October period.

If Cities Service were to supply its customers' current requirements (using ERA's assumed 3% demand increment) and reach the targeted inventory at October 5, it would need to purchase 7,300M barrels of product. These volumes have not been, nor are they anticipated to become, economically available.

Cities Service has discussed purchases of outside products at the current high spot market prices with its customers. Since the purchased product would constitute a significant portion of Cities Service's supply, the roll-in of purchase penalties would have a major impact on Cities Service's distillate selling prices. As a result, Cities Service and its customers agreed that a major product purchase program is not economically feasible at this time.

Cities Service intends to achieve desired distillate inventories by November 1 by curtailing deliveries to its customers during the May-October period. Effective May 1, Cities Service announced that No. 2 oils sales would be limited to 50% of sales in the same month of 1978 except for defense, agricultural, energy production and transportation, and essential services requirements which would be limited to 100% of sales in the 1978 period. That program has been modified to provide for current agricultural requirements as recently mandated by Special Rule No. 9. Cities Service believes that its customers, by buying substantially smaller quantities, stands a better chance of obtaining supplemental product without fueling further increases in spot market prices.

It should be emphasized that Cities Service's decision to forego a distillate/feedstock purchase program will not significantly affect the distillate supply in this country. Volumes which had historically been purchased by Cities Service will be available to other purchasers. Cities Service recommends that yield or inventory build-up programs which may ultimately be adopted by ERA should recognize changes in a refiner's ability to purchase historical volume of products from other refiners.

Question No. 2

Do you plan to renew existing supply agreements with jobbers and deep water terminal operators?

Answer

Yes, we do not intend to cut off any contract customer. Although volumes will be curtailed over the next several months, as discussed above, in order to build inventories to desired levels, we anticipate having a 100% allocation factor during the coming heating season.

Question No. 3

What degree of flexibility do you have between distillate and gasoline production yields? i. e. to what extent can you increase the distillate yield and what would be the corresponding effect on your gasoline yield?

Answer

As indicated above, Cities Service has the capability of diverting virgin light gas oils from cat cracker feed directly to No. 2 fuel blends at its Lake Charles Refinery. As a practical matter, this gives us the flexibility to swing approximately 6,000 B/D, thereby increasing No. 2 fuel production and reducing gasoline production by a like amount.

Question No. 4

What is your average projected crude runs level for the June-September 1979 period?

Answer

Cities Service's operating plan is based on crude runs of 278,000 BPSD during the June-September period.

Question No. 5

What are your current distillate production plans for the May-October 1979 time period?

Answer

During the year 1979, we anticipate producing 21,500M barrels of distillate, an increase of 500M barrels over 1978. During the May-October 1979 period, we anticipate a distillate yield of 10,491M barrels.

Question No. 6

Comment on ERA's assumptions with respect to Cities Service.

Answer

The scenario developed by ERA covering Cities Service is deficient in that it relates distillate production to crude rate only. Thus, the scenario does not accurately reflect Cities Service's operations which have historically involved substantial volumes of purchased finished products and gas oil feedstocks. Also, the use of average industry yield patterns causes a severe penalty to Cities Service's refinery which has equipment to produce at least 10% more gasoline than the average refinery. The fallacy of ERA's assumptions is best demonstrated by the fact that even if Cities Service were to shift to maximum distillate production, it would be unable to meet targeted inventory levels without curtailing distillate sales during the May-September period. The shortfall would result from our inability to secure economic purchased product.

Cities Service contends that any mandated yield pattern and/or inventory target should consider these factors.

Question No. 7

Comment on projected crude runs for the industry.

Answer

Crude runs in excess of 150 15,000M B/D for the period May-October may be too optimistic. Total crude available from foreign sources may not permit operation at these levels. Crude supply disruptions due to weather or shipping delays and planned maintenance scheduled for the summer months at northern refineries are also important factors. Second quarter levels of operation have historically been below 87.0% of capacity. The third quarter reached 90.5% in 1977, and the level was 90.8 in the fourth wuarter of 1978. Cities Service has projected industry utilization rates of 86.9% and 90.2% for the second and third quarters of 1979, respectively.

Question No. 8

Comment on the level of historic imports assumed.

Answer

Cities Service essentially has no information on the level of imports for the industry. We are actively seeking product from outside the United States and presume others are doing the same. Other major oil consuming countries are faced with shortages of finished product, and significant increases in imported volumes are unlikely.

Respectfully submitted,

C. D. Head, Jr.
Manager, Federal Energy
Regulations Department

CDHJr:kd

7/18/79

CITIES SERVICE COMPANY
NO. 2 DISTILLATE PRODUCTION & PURCHASES
(M BBLS)

Month/Year	Total Crude Runs	No. 2 Oil Yield From Crude	% Yield From Crude	Daily Average No. 2 Oil From Crude	Inputs of Cat Feed Stock	Total No. 2 Oil Yield From Cat Feed Stock	% Yield From Cat Feed Stock	Daily Average No. 2 Oil From Cat Feed Stock	Total Daily Average No. 2 Oil Production	Volume No. 2 Oil Purchases
Jan '78	7806	1125	.144	36	260	221	.85	7	44	(1)
Feb	6904	897	.130	32	175	149	.85	5	38	(31)
Mar	7865	1563	.199	50	-	-	-	-	50	11
Apr	7841	1596	.204	53	319	271	.85	9	62	1
May	7571	1003	.132	32	710	604	.85	19	52	189
Jun	7674	1456	.190	49	364	309	.85	10	59	2
Jul	7627	1455	.191	47	514	437	.85	14	61	994
Aug	7250	1200	.166	39	849	722	.85	23	62	549
Sep	7571	1579	.209	53	381	324	.85	11	63	460
Oct	8185	1704	.208	55	96	82	.85	3	58	285
Nov	8441	2018	.239	67	88	74	.85	2	70	12
Dec	8689	2338	.269	75	-	-	-	-	75	2
					3756	3193				
Jan '79	8419	1571	.187	51	137	117	.85	4	54	(1)
Feb	7341	1182	.161	42	446	379	.85	14	56	(20)
Mar	8201	1463	.178	47	133	113	.85	4	51	15
Apr	7503	1300	.173	43	86	73	.85	2	46	(11)
May	8251	1450	.176	47	39	33	.85	1	48	10
Jun	7925	1274	.161	54	-	-	-	-	54	416
Jul	6975	1457	.209	47	-	-	-	-	47	-
Aug	6975	1705	.244	55	-	-	-	-	55	-
Sep	7650	1470	.192	49	-	-	-	-	49	-
Oct	6975	1612	.231	52	-	-	-	-	52	-
Nov	6975	1530	.219	51	-	-	-	-	51	-
Dec	6975	1860	.267	60	-	-	-	-	60	-
					841	715				

Mr. MOFFETT. Gentlemen, we are nearing the end of our time with you. Let me ask you a question.

What kind of assessment or prediction do you have about the winter? I know you are not weathermen, but do you have a prediction?

Mr. WAGNER. The best we can ever do is project a normal winter. We subscribe to some long-range weather services. I have not seen them yet for this winter. They are, at best, a guess.

Mr. TEBO. Our projections are spotty also. We go on the belief that it is hard to believe that we would have three winters in a row like we have had the past two. I don't know.

Mr. MOFFETT. It may be hard to believe, but there are reputable people in that community of long-range forecasting that say we are in a period where the trend is clearly significantly above normal temperatures through the winter of 1981. That is, below normal. There will be significantly below normal temperatures through the winter of 1981.

That ought to be factored into the predictions. I do not understand why, if there is anything representing a consensus in the weather forecasting community, that you would make your own plans based on a normal winter and based on the fact that you find it hard to believe that we would have another winter like last year which was 18 percent below normal, as I recall.

Mr. TEBO. All of our projections have been based on a winter like last winter.

Mr. MOFFETT. They have?

Mr. TEBO. Yes, they have.

Mr. MOFFETT. If there are no further questions, we want to thank you gentlemen for your testimony and the time you have spent with us. We appreciate it very much.

The Chair now calls our next panel.

We have Mr. Wayne Dirks of the Getty Refining & Marketing Co.; James Clapp, Getty Refining & Marketing; Algernon Johnson, Minnesota Energy Agency; and Bob Anderson, administrator, energy division, Department of Natural Resources and Conservation, State of Montana.

Will you gentlemen please come to the witness table and be sworn in. Please raise your right hand, gentlemen.

Do you solemnly swear the testimony you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

[Chorus of "I do's."]

Mr. MOFFETT. Please be seated.

Mr. Dirks, please proceed and please identify yourself.

STATEMENT OF WAYNE DIRKS, MANAGER, PETROLEUM MARKETING, GETTY REFINING & MARKETING CO.; ACCOMPANIED BY JAMES CLAPP, MANAGER, PRODUCT SUPPLY; AND EUGENE F. GERVINO, ATTORNEY

Mr. DIRKS. Thank you, Mr. Chairman.

I am Wayne Dirks, manager of petroleum marketing for Getty Refining & Marketing Co., headquartered in Tulsa, Okla.

With me today is Jim Clapp, our manager of product supply. Our remarks at this hearing will address special rule No. 9 and its effects on our business, after which we will be happy to answer questions.

Overall, special rule No. 9 in conjunction with the company's lowered inventories and negative exchange balances has caused problems for our customers and the consumers of our products. Instead of being able to sell distillates as equitably as possible to all customers, we have had to greatly revise our distribution of the products to meet Government regulations which gave top priority to agricultural customers.

The temporary priority given agricultural production distorted the distillates market, caused confusion and contributed to protests by users of distillates for other than agricultural purposes.

It is very unfortunate that our customers had to spend hundreds, perhaps thousands, of hours certifying to us their agricultural requirements within the last month, only to have yet another amendment to special rule No. 9 negate their efforts last Friday.

Getty Refining & Marketing Co. employees also spent thousands of hours designing and putting into operation a complex system to implement compliance with special rule No. 9.

In May, the company's middle distillates inventories were very low. As a result of the inventory situation and special rule No. 9, the company decided on May 22, 1979, to suspend sales and to set up a new terminal loading authorization procedure. We resumed sales on May 25, on a limited basis, only to customers who had certified to us their agricultural requirements, in accord with special rule No. 9.

Our new terminal loading authorization system was designed to enable us to channel the products we had available to the temporary high-priority customers established by the rule.

Without going into great detail, the new loading authorization system worked like this. When agricultural certification was approved in our Tulsa headquarters, one of our district offices was notified. they immediately notified customers of their approved agricultural volume and that each of their requests for a load must be cleared by telephone with the company's district office prior to loading. The district offices then authorized each certified order to be filled one load at a time based upon the sequence in which the requests were received in the district offices.

The new terminal loading authorization procedures allowed the company to deny customers future product loadings if they exceeded certified volumes. Customers were informed of this by the district offices at the same time they were notified of their approved agricultural volume.

We had received agricultural certifications from most of our customers, and we had processed and approved approximately 85 percent of them. Had the balance of the certifications amounted to the volumes anticipated, we would have been able to supply 100 percent of the certified agricultural requirements prior to July 31, which was the end of the special rule No. 9 program.

This projection was contingent upon certifications under the amended special rule No. 9 not exceeding our expectations.

After we had satisfied requests from customers certified under special rule No. 9 and its amendment, we planned to resume selling distillates to customers for other needs. We also anticipated returning to an allocation program for all customers in early August.

We had received certification statements from 647 customers for a total of 57 million gallons and expected that the total volume to be certified to us in our central region would amount to 90.6 million gallons. Of the 90.6 million gallons, the company estimated that it would ask the DOE to verify certification of 25 million gallons.

We anticipated that the DOE would ask us to supply 15 million gallons, or 60 percent of the disputed amount. That would have left us with a supply obligation under special rule No. 9 of 80.6 million gallons, compared to total sales in the region of 90 million gallons in the May, June, and July 1978 period.

Mr. Chairman, with your permission, I would like to depart from my statement to clarify what I have just said.

Contrary to what our statement suggests, it is not actually the company that asks DOE to verify disputed certifications. Rather, these disputed certifications are returned to the customer who may so or may not elect to pursue the matter further with DOE. If the customer elects to ask DOE for certification of the disputed amount, the resulting DOE decision is then made known to us. We rejected 25 million gallons of certified demand which became subject to possible forwarding to DOE for its verification. Our estimate that DOE would ultimately verify 15 million gallons of disputed agricultural demand should be ignored. Based on information received this morning, we have actually received back from DOE 1.8 million gallons of disputed certification.

Of course, since special rule No. 9 has now been changed, we will never know what portion of the disputed 25 million gallons would have been forwarded to DOE by our customers or how DOE may have dealt with them.

Now that special rule No. 9 has been amended again, however, we must attempt to return to a more equitable distribution of the distillates we have available.

That concludes my presentation. Mr. Clapp and I would be happy to answer any questions you might have.

Mr. ECKHARDT [presiding]. Mr. Anderson?

You may proceed as you see fit.

STATEMENT OF BOB ANDERSON, ADMINISTRATOR, ENERGY DIVISION, DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION, STATE OF MONTANA

Mr. ANDERSON. My name is Bob Anderson. I am the administrator of the Montana Energy Division. The State of Montana is apparently experiencing the most severe shortage of diesel fuel of any State in the country. Our understanding of the seriousness of the problem stems from: (1) Information provided by the major oil companies operating in the State; (2) the astronomical increase in applications for State set-aside diesel fuel; and (3) the problems and uncertainties most sectors of the Montana economy are encountering in trying to obtain enough fuel to maintain normal levels of operation.

Following are some specific examples of economic disruption in Montana due either to the shortage of diesel fuel or to the truck strike:

One coal mining company has discontinued its reclamation of strip-mined lands in order to continue to operate coal mining equipment. The other mines foresee a 40-percent cutback in production after July.

The forest products industry has been particularly hard hit, either because of the diesel shortage or due to the truck strike. Of the 16 mills sampled, 10 have shipping problems. Mills reported shipping reductions as high as 95 percent and associated employee layoffs. One company has suspended its logging operation, leaving almost 100 men idle.

In May truck stops were supplied with approximately 80 percent of what they sold in May 1978. As a result of special rule No. 9, the truck stops were further cut to an average allocation fraction of 45–50 percent in June. A June 22 survey of 29 truck stops across Montana indicated that one truck stop has closed and four others are completely out of diesel fuel.

If the truckers were not striking, 27 of the truck stops reported that they would have been out of fuel by midmonth. However, because the truck strike has reduced demand, some of the truck stops have been selling what little fuel thay have to agricultural producers who were unable to secure diesel in spite of special rule No. 9.

At least two interstate highway construction projects have been either delayed or curtailed, due to a shortage of diesel fuel. Compounding this problem is the difficulty of getting materials such as cement delivered to job sites; again as result of the truck strike.

Agriculture, the backbone of Montana's economy, has required special fuel assistance to maintain a normal level of operation. In addition to the problems associated with reduced allocation fractions, this spring's weather had contributed tremendously to agricultural fuel demand. Much of the work normally done in April was pushed into May this year because of cold weather. A late spring frost destroyed the winter wheat crop over a significant part of the State. This land had to be reworked and replanted, essentially doubling the fuel requirements for those agricultural producers.

Because of the dry conditions this spring, some ground required additional plowing before planting. Also, a lack of soil moisture made it necessary to start irrigation pumps earlier than last year. Summer fallowing is incomplete, endangering next year's crop. We are especially concerned about an adequate fuel supply for this year's harvest which will begin in about a month and reach its peak in mid-August. If fuel supplies are not adequate, or even if they are rumored to be inadequate, custom cutters may avoid Montana. The result could be catastrophic.

Other problems involve road and highway maintenance, oil and gas drilling, and delivery of products to retail stores.

Table 1 shows the estimated supply of diesel available in Montana for May and June 1978 and 1979, the total volume of diesel in the State set-aside, the total volume of requests for the set-aside, and the documented shortfall.

Mr. Moffett. Without objection, a copy of table 1 will be inserted in the record at this point.

[The material follows:]

TABLE 1

MONTANA DIESEL SUPPLY SITUATION
(gallons)

	TOTAL DIESEL SUPPLY [1]		SET-ASIDE DIESEL		APPLICATIONS FOR SET-ASIDE		ESTIMATED DIESEL SUPPLY SHORTFALL	
	1978	1979	1978	1979	1978	1979	1978	1979
MAY	20,400,324	20,276,979	0	861,686	0	2,912,732 [2]	0	2,051,046
JUNE	20,613,306	19,943,490	0	799,680	0	5,824,299 [3]	0	5,024,519

[1] Estimates calculated from Form 1000's anticipated supply volume.

[2] Includes 139 applications.

[3] Includes 243 applications.

Mr. Anderson. The supply available in May 1979 was approximately 123,000 gallons less than in May the year before; the June 1979 supply is nearly 670,000 gallons less than that of June of 1978.

There was no diesel set-aside in May and June of 1978. In May of 1979, 130 fuel users and distributors applied for 2,912,732 gallons of set-aside diesel, which indicates a shortfall of about 2 million gallons.

The documented shortfall as of June 17 was over 5 million gallons, compiled from a total of 243 applications. This was about 20 percent of the demand.

Special rule No. 9 created many more problems in Montana than it solved, and as of mid-June there was no evidence that it helped alleviate the problem of short fuel supplies for anyone, including priority consumers.

Special rule No. 9 was intended to provide fuel to meet 100 percent of agricultural needs. Since the rule was not enacted until May 10, it was too late to affect the May allocations to distributors. The burden in May fell to distributors to supply 100 percent of agriculture's needs from their existing May allocation which was already, in most cases, at only 80 percent of the May 1978 allocation.

Montana is a petroleum product exporting State. In fact, nearly two-thirds of the diesel fuel produced in Montana is exported to other States. Therefore, we cannot understand why we are apparently suffering the worst diesel shortage in the country. Federal regulations are not working, and the free market is not working.

Special rule No. 9 suffered from three fatal flaws. First, the rule did not specify the procedures which were to be followed.

Montana has 23 prime oil suppliers, and, as a result, there were 23 different interpretations of special rule No. 9. No company took prompt action to insure that the rule was implemented. Distributors were required to recertify the fuel needs of their priority customers. Fuel suppliers often questioned recertification forms and, in many cases, refused to supply additional fuel above the distributor's existing allocation.

The oil companies did not interpret special rule No. 9 to include all of the related activities noted in the Federal definition of agricultural production. Logging and sawmill operations were included in the definition, but this sector of the Montana economy was not accorded special access to fuel.

Many fuel distributors exhausted their inventories in May and overdrew on their June allocations to supply their agricultural customers. The oil companies are apparently not allowing further overdrafts and are holding the jobbers to their previous ones. Combined with the nonimplementation of special rule No. 9, a number of fuel suppliers in agricultural areas have little or no allocation for June.

The second flaw of special rule No. 9 was a lack of enforcement. No method was provided for insuring that certifications were accurate and honest or that suppliers and distributors were implementing the rule.

Third, special rule No. 9 placed the oil suppliers and the distributors in the role of deciding how to allocate diesel fuel among the nonpriority users. Social welfare can hardly be optimized when economic decisions of the magnitude of fuel allocation are made by apron attendants at truck stops.

Even though Montana is an agricultural State and even though special rule No. 9 was intended to help agriculture, it did not and could not work. We applaud its virtual revocation and we caution the Department of Energy not to try to solve serious problems with ill-conceived and ill-designed rules.

Montana does not have adequate staff, funding, or data to administer the set-aside program. There has been a 4,000-percent increase in the set-aside workload since 1978. For example, in May and June 1978, there were 5 and 17 applications, respectively, for set-aside gasoline. By comparison, in May 1979 there were 230 applications for both gasoline and diesel. As of June 17, 1979, there were 243 applications. No staff is available to provide audits and investigations to insure that set-aside requests are legitimate.

This office has been averaging well over 100 phone calls a day from: (1) persons unable to supply fuel to their customers; (2) commercial and industrial enterprises which are unable to obtain fuel and which face curtailment of their operations of closure of their business; (3) persons who need help in interpreting complex and changing Federal regulations; and (4) persons needing information on how to implement special rule No. 9.

The Agricultural Soil Conservation and Stabilization Service has supplied the Energy Division with two persons to monitor agricultural fuel needs and assist in handing special rule No. 9. The Department of Energy temporarily supplied one person to assist in shifting fuel supplies to mitigate the effects of the shortage. However, according to the oil companies, there were no supplies to shift, so this person returned to DOE.

The State has experienced major difficulties in obtaining funds necessary to hire additional staff. Montana desperately needs Federal assistance in order to effectively operate this federally mandated program.

In conclusion, Montana has the following recommendations:

Full allocation and price controls should be promulgated for middistillates, similar to those in effect until July 1, 1976. Only with full allocation controls can Montana's economy have equity with the economies of the other States. Only with full allocation controls can our fuel supplies be predictable and our citizens have some certainty about their future.

Federal price and allocation controls can only be considered a remedial measure, however. Over the long term, the market must be allowed to come into play so that the full cost of our energy consumption is known and borne by the appropriate entities. We therefore favor decontrol of petroleum in accordance with the current schedule.

Over the long term we must lessen our reliance on fossil fuels, especially petroleum. To do otherwise is suicidal. We must have better matching of energy forms with energy end uses. For example, it seems foolish to heat water and space with electricity when low grade heat can do the same job, especially when that electricity is generated with oil.

We must have more aggressive conservation so we no longer throw away more energy per capita than most people in the world use. And ultimately, we must make a transition to reliance on renewable forms of energy.

Mr. MOFFETT. Thank you, Mr. Anderson.

Our next witness is Mr. Algernon H. Johnson.

Mr. Johnson, would you please stand and be sworn?

Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. JOHNSON. I do.

Mr. ECKHARDT. You may proceed.

STATEMENT OF ALGERNON H. JOHNSON, DIRECTOR, MINNESOTA ENERGY AGENCY

Mr. JOHNSON. Thank you, Mr. Chairman.

Mr. Chairman, my name is Algernon H. Johnson. I am director of the Minnesota Energy Agency, with a staff of 110. We are one of the largest agencies or energy entities in the United States. We have quite a bit of data and background and abilities, but we are caught with insufficient staff to really respond to what we have been going through.

I welcome the opportunity to speak here today because, as you will see from my testimony, Minnesota is seriously short of middle distillate supplies.

We feel that it is time Congress, as well as the administration, took some positive steps toward dealing with the overall petroleum situation in this country. We can no longer afford to be stuck in a mire of debate on the Federal level that leaves the States to fend for themselves.

The problem of middle distillate and gasoline shortages is a nationwide and, indeed, worldwide problem that unfortunately cannot be solved by the action of the States alone.

Supplies of middle distillates to Minnesota have dropped substantially in the past 2 months. In June, according to EIA-25 reports, deliveries are 87.3 percent of June 1978 deliveries.

Demand in the first 4 months of the year was up 23.1 percent over last year. While this high demand was due in part to the severely cold winter, there has also been a sharp increase in diesel fuel use.

I would like to point out that we monitor our primary storage weekly. We set a target of 1 million barrels during the winter, and if we drop below that, we ring a bell. We look for emergency procedures. We penetrated that in March. Because we felt we were late enough in the year we did not declare an emergency.

But the net effect was that we reduced our primary storage down to 750,000 barrels last winter, the lowest that we have records for.

Highway use of middle distillates in the first quarter of 1979 was up 21.9 percent in Minnesota over last year. Since 1976, demand for distillates has climbed at an average rate of 9 percent per year.

We do have records back to 1965. At that point highway use of distillates accounted for 6.9 percent of the total use in the State. In 1978 that had climbed to 18.7 percent, or 250 million gallons.

What this means is that demand has outstripped supplies. This is reflected in seriously low inventories of distillate fuel in the State. Primary storage figures gathered from the four Minnesota-area refineries and two product pipeline companies—80 percent of our primary storage—show that distillate stocks are down 37.2 percent from last year.

We currently have approximately 1.6 million barrels of middle distillates in inventory. That is 800,000 barrels behind last year.

Our short-term supply and demand projections show a continuation of this problem, and more important, the forecast shows that we will not be able to build stocks of fuel oil for the winter without seriously shortening agriculture, transportation, commercial/industrial, and residential users of middle distillates.

Demand for middle distillates over the next 3 months—excluding primary inventory buildup for winter—is expected to range between 75,000 and 86,000 barrels a day. Estimates of supplies shows that the 4 area refineries and the 2 product pipelines expect to deliver 60,000 to 63,000 barrels a day in the same period.

I would like to point out that our four area refineries have run flat out for over a year. The two majors have not gone down for maintenance. They are going to have to go down this summer, before fall. They have been in excess of 90 percent. They have not tilted toward gasoline. They have produced between 10 and 15 percent more distillate in this past year than they have in their past history. They do not intend to tilt toward gasoline at all.

However, we believe that primary inventories in the State must be built to 4 million barrels by the end of October to meet winter heating oil needs, plus the other traditional uses.

This means that the State needs an additional 25,000 barrels a day between July 1 and October 31 to meet this target.

I refer to the attachment to my statement entitled "Distillate Fuel Oil Primary Inventory Targets," which I would ask be inserted in the record at this point.

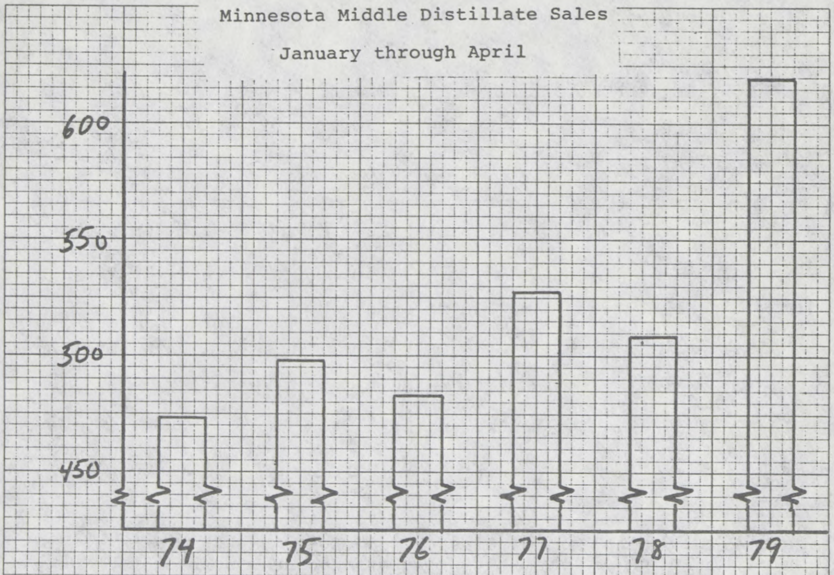
Mr. MOFFETT. Without objection, so ordered.

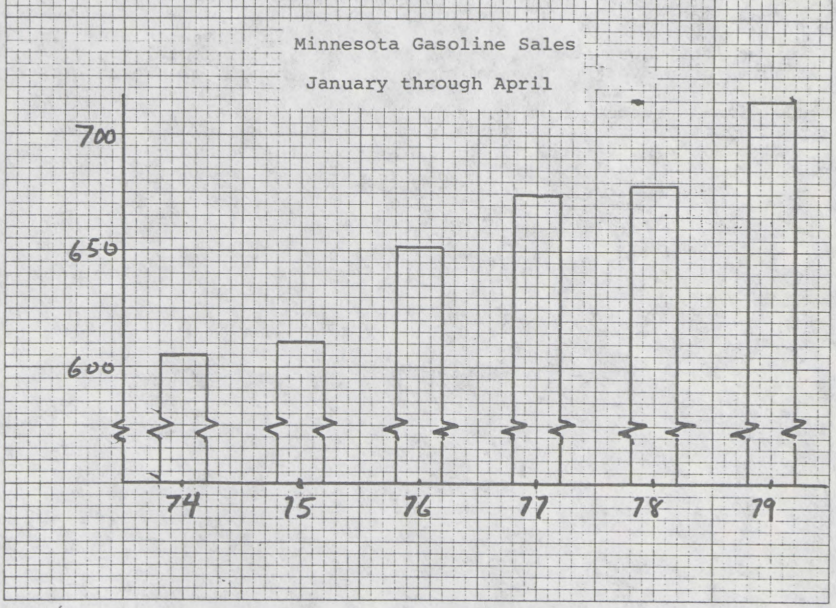
[The material follows:]

1979 Middle Distillate Fuel Oil Demand and Supply Forecast

- thousand barrels per day -

1979	Trucks	Aviation	Industrial	Agriculture	Electrical Generation	Residential/ Commercial	Misc.	Total	1978 Actual	Projected Supplies
Jul.	21.8	15.7	26.6	6.0	5.4	-	0.4	75.9	52.1	63
Aug.	22.0	15.5	26.6	1.2	4.7	-	0.4	70.4	64.0	63
Sept.	23.8	15.5	26.6	13.0	7.2	-	0.5	86.6	71.8	?
Oct.	24.8	13.9	26.6	7.2	5.7	16.9	0.5	95.6	94.1	?
Nov.	24.7	14.5	26.6	10.0	6.2	24.5	0.6	107.1	99.5	?
Dec.	22.1	13.3	26.6	0.8	8.6	61.2	0.7	133.3	137.5	?
Average								94.8	86.5	82.175


Minnesota Middle Distillate Sales
January through April
600
550
500
450
74
75
76
77
78
79


Minnesota Gasoline Sales
January through April
700
650
600
74
15
76
77
78
79

Attachment

DISTILLATE FUEL OIL PRIMARY INVENTORY TARGETS

	Date	Monitored Primary Inventory	Total Primary Inventory
Actual	6/14/79	1.35 mm bbls.	1.69 mm bbls.
Projected*	6/21/79	1.35 mm bbls.	1.69 mm bbls.
Projected**	6/29/79	.90 mm bbls.	1.13 mm bbls.
Target***	7/31/79	1.48 mm bbls.	1.85 mm bbls.
Target	8/31/79	2.06 mm bbls.	2.58 mm bbls.
Target	9/30/79	2.62 mm bbls.	3.28 mm bbls.
Target	10/31/79	3.20 mm bbls.	4.00 mm bbls.

* Assumes that suppliers will not build stocks due to tight supply and high demands, but will not draw on stocks due to already dangerously low levels.

** Assumes that announcement of DOE action will allow suppliers to draw down stocks, anticipating imminent shipment of product.

*** Additional product shipments of 25,000 bbls./day allow primary stocks to build at the rate of 23,370 bbls./day with monitored primary stocks increasing at the rate of 18,700 bbls./day.

Mr. Johnson. I would like to point out also that the fact that we have this information—and most of it is proprietary, and we just summarize it. We have kept it proprietary so that we retain credibility with the oil companies. They are also extremely interested in the summary figures that we give. I believe they do not talk with each other.

They are only concerned with their marketplace in the State. They have no idea what they do and its impact on the total picture. So, they are just as interested in the weekly figures that we give out as people in the retail end of it.

All indications from the requests throughout State set-aside programs point to seriously depleted secondary storage as well. The State set-aside for June was 2.7 million gallons. That is the first gallon figure I have used. Everything else has been barrels.

It is not adequate to meet the demands for set-aside. By June 15 of this month, all of the middle distillate State set-aside was used. Large users, such as barge companies and the taconite industries, were refused requests for set-aside.

These include: C.M. St. P&P Railroad Co., 250,000 gallons; Twin City Barge & Towing—coal, oil and grain—525,000 gallons; Waterways Winona—coal and grain—200,000 gallons; Marine Fueling Division, Great Lakes—taconite—200,000 gallons; Erie Mining—taconite—520,000 gallons.

I might point out that the barge companies were told by pushboat operators that they would not go beyond St. Louis unless they were guaranteed fuel at the head of the river. We have two midstream refuel spots in Minnesota.

They do have a way to respond to this. They can bring fuel up, the spot market distillates, from the gulf.

But we have the taconite industry. That can have a very dramatic domino effect. We have about 20,000 people employed in mining and manufacturing of taconite pellets. We have one company down to about 15 days supply of fuel. They can take out of inventory for awhile, but ultimately it is going to affect steel mills all the way from Chicago to Buffalo.

We have received approximately 3,000 requests for middle distillates through the State set-aside program over the past 3 months.

Jobbers report to us that they have not started any summer fill programs for heating oil during the winter. It is normal practice in Minnesota to fill secondary storage at this time for winter heating needs. The fact that this is not being done points out our special problems in this State.

While we have the necessary expertise and data to administer the set-aside program in the State, we do not have the available funds to support the staff needed to do the job right. We are quite literally swamped with requests and have seriously shorted other State mandated programs to handle set-aside requests. It is our position that the Federal set-aside program be supported with Federal funds. Otherwise we may be forced to turn back set-aside fuels for lack of personnel to handle the requests.

In Minnesota this spring, the planting season was delayed due to cold and rainy weather. Thus the demand for diesel fuel for agricultural use was concentrated in a few weeks at planting time in late May and early June. In anticipating of this problem—Minnesota, through the Midwest Governors' Conference, appealed to DOE to direct their attention to the agricultural needs in the Midwest.

The result was special rule No. 9. It was our feeling almost immediately that the way the rule was drafted would make it ineffective. This impression has been verified during the past month by the number of requests for State set-aside received from suppliers for agricultural needs.

In fact, a large portion of the June set-aside went to farm uses, despite the fact that rule No. 9 was in effect.

It is our position that there are short-term supply problems that may require that fuel be directed at one or another segment of the economy for a limited period of time, even at the expense of some other segment.

However, such a rule must be in a form that makes it effective. Unfortunately, special rule No. 9 was quickly lost in a quagmire of certification questions.

It is impossible for us to assess how much fuel was diverted to farms away from nonpriority users due to special rule No. 9. However, we have also received requests for set-aside from truck stops, industries, and commerical institutions.

We have no evidence of false certification for agricultural needs in the State. However, many suppliers voiced the fear that false certifications would be made. This seems to have led some suppliers into making extremely strict rules for certification that made it almost impossible for the rule to work.

For example, one supplier required notorized certifications from each farmer of the amount of fuel needed.

Another problem with the rule is that some suppliers, such as farm cooperatives with mostly agricultural customers, simply did not have the supply available to meet 100 percent of farm needs.

A far more effective measure to deal with part of the supply problem would be the reinstitution of allocation controls on middle distillates. A mandatory nationwide allocation fraction would assure a more equitable distribution of available supplies.

Currently, deliveries to Minnesota via the Williams Pipeline are substantially lower than last year. We checked the deliveries just about 2 weeks ago. They were 1.5 million barrels down in inventory in the system.

Phillips Petroleum, Gulf, Getty, and Kerr McGee have not delivered the amount of fuel stated in their June EIA-25 reports. Houston spot market prices for No. 2 fuel oil are more than twice what they are in Twin Cities, making it difficult to find product to put into the pipeline.

In addition, Minnesota has asked the Department of Energy, via letter on June 15, to redirect 25,000 barrels per day of fuel oil to Minnesota between now and October 3, to help build our distillate supplies in storage for the winter.

However, the shortage of middle distillates is a nationwide problem, and it is difficult for Minnesota to obtain additional product to build stocks for winter heating while supplies are also short elsewhere.

For this reason, Minnesota asks that distillate production be maximized nationwide as it is in Minnesota. When the trade-off is between home heating in January and driving cars in August, we think the choice is obvious.

I really do not know of any nonessential diesel use. I do not know of any diesel motor boats, but I think we have some place to go with discretionary driving in this country.

We would also like to see measures put in place to maximize the use of coal-fired electricity in place of distillate-fired generation. I would point out to Mr. McCloskey that there is more middle distillates used to generate electricity in California that we use for all purposes in Minnesota.

Mr. McCloskey. I agree. I hope we will change that policy. We have been very luxurious in the last 4 years.

Mr. Johnson. The use of distillates for anything but peaking capacity places an enormous and unnecessary drain on distillate supplies. On the other hand, wherever distillates are needed to produce or transport coal—such as on barges—every effort should be made to make those distillate supplies available.

What I have proposed so far are measures that will affect supplies to Minnesota. However, I think the area of most pressing need is on the demand side. The fact that demand for diesel is up almost 22 percent in this State is astounding. There is no way we can absorb such a huge increase in demand on a nationwide basis.

Congress must address itself to a comprehensive plan for each sector of the economy that will cut demand. This means agricultural, transportation, electrical generation, and home heating.

For example, we can greatly increase the efficiency of our trucking fleets, use rail transportation more effectively, provide incentives for the use of coal in electrical generation, and weatherize homes and businesses at a much faster rate than is now being done.

To be effective, these problems must be done nationwide and conservation funds must be made available to each State to carry out State-level programs.

I would point out that EMPA is struggling. We have some question about the EPCA and the EES funds. They would all impact dramatically on our conservation division if we do not receive those funds.

We are currently mounting an all-out effort to reduce demand for distillates this fall and winter in Minnesota. But this effort will not be enough. Without quick decisive action from the Federal level—both Congress and the President—we will not be able to handle this problem.

Thank you.

Mr. Moffett. Thank you for that excellent testimony.

The Chair now recognizes the gentleman from Texas, Mr. Eckhardt.

Mr. Eckhardt. Thank you, Mr. Chairman.

Mr. Dirks, how much of the oil which Getty used does itself produce domestically?

Mr. Dirks. Sir, I do not have that information with me.

Mr. Eckhardt. How about roughly? About what percentage of its own domestic oil does it run in its refineries?

Mr. Dirks. As an estimate, our domestic production is approximately 250,000 barrels per day. I believe our total worldwide production is 460,000 barrels per day.

Mr. Eckhardt. What about the percentage of domestic production that you run through your refineries per day?

Mr. Clapp. Mr. Eckhardt, I will respond to these questions.

Neither one of us are in the crude oil end of the business, so we cannot give you estimates. We will be happy to supply hard data later for the record.

Mr. Eckhardt. I would like to ask unanimous consent that the record be kept held open.

Mr. Moffett. Without objection, it will be held open.

So ordered.

[See p. 95, for question 2 answer.]

Mr. Eckhardt. We do not have to have exact figures for this. The situation that exists has existed over the last few years with respect to crude oil production. Crude oil production ran at a pretty steady rate in 1976, and 1977, and then moved up rather sharply in 1978. In 1977 and 1978, you saw some seasonal decline in the first part of the year, as you see in 1979.

However, there has been a rather sharp decline in crude oil production in the period from approximately November 1978 to the present period.

There is an upward movement through, I think, about April, and then a decline again. Therefore, I am using only rough figures that I have calculated somewhat rapidly here, but the average daily production over all of 1978 was about 8.7 million barrels per day, that is, domestic production.

However, the average for the months of this year up until now have been only 8.4 million barrels, which would mean a shortfall each day on the average of about 300,000 barrels.

I understand that the DOE has estimated several reasons for the decline in middle distillates stocks. One, the gasoline demand, which we have discussed here, and the tendency of refiners to tilt toward gasoline or not tilt toward diesel seasonally to the extent they had before.

Two, reduce crude oil runs as a result of the Iranian situation.

Three, the weather.

However, they do not mention the fact of decreased crude oil production during that period.

I must say that presently crude oil production per day is somewhere close to the 1978 figure, but it is somewhat declining, to a certain extent.

Can you explain the reason for that?

Mr. Clapp. No, sir, I cannot.

Mr. Eckhardt. It does not seem that the decrease in discovered reserves would affect that because that would affect it only very slowly. There is the question of an actual decline in reserves. That would only affect that production very slowly; would it not?

Mr. Clapp. It is my general understanding that production from the lower 48 States has been declining steadily for the past several years.

You were speaking of a decline over and above what we have been experiencing?

Mr. ECKHARDT. Over the period that I have described, that is not so reflected. Of course, the period I am describing is a rather recent period from 1976 through the present time.

There has been something of an increase in production over that period.

Mr. CLAPP. Of course, we have had the North Slope oil come onstream in that period.

Mr. ECKHARDT. Oh, I see. You are talking about the lower 48. I am talking about the whole domestic production, including Alaska.

Mr. CLAPP. I see.

Mr. ECKHARDT. At any rate, it is difficult for me to see why there should have been a decline in domestic production during the first months for this year and also in the last months of last year when there has been such an enormous and voracious appetite for oil and for gasoline.

This is true, of course, unless it is that producers would rather delay production for a higher price after the President's phaseout of price controls as of June 1 of this year.

That, of course, might explain it.

However, I cannot see any grounds to explain the decline during this period of time. Certainly, it must impact on the question of your petroleum runs, both to middle distillates and to gasoline.

Mr. DIRKS. I do not have an answer to your question from an industry standpoint, but again, we will be very happy to furnish you with this information as it pertains to Getty Oil Co.

Mr. ECKHARDT. I would like to know whether or not you have experienced the same decline that is indicated in the total curve of production in 1976, 1977, and 1978 and the first months of 1979.

If I may briefly describe that, what it would show is that in 1976 there would be an equal flow of production through all the months without even the seasonal decline.

In 1977 and 1978 there were some dips at the beginning of the year and the early spring. However, there was a very sharp dip in 1979 which was not recovered from nearly as quickly as in 1978 or 1977.

There was a decline of about 300,000 barrels per day during 1979 as compared with the average in 1978.

I would like to see what your figures show on that basis and if you have any explanation for oil production decline during that period of time.

Mr. CLAPP. As I stated earlier, neither of us are in that end of the business. We will be happy to furnish production figures for our company for the period in question.

Let me make sure I understand what you are after.

Would you like monthly production figures for our company for domestic production for the years 1976, 1977, and 1978?

Mr. ECKHARDT. And 1979 to the present date, please.

Mr. CLAPP. We will be happy to provide that.

Mr. MOFFETT. Without objection, so ordered.

[The material follows:]

QUESTION 1. What are Getty's domestic oil production figures (compared to total U. S. production) for the years 1976, 1977, 1978 and the beginning of 1979 on a monthly basis?

(a) Is there an unusual decline in production in late 1978 and early 1979? If so, why?

DOMESTIC OIL PRODUCTION - MB/D

	1976 Total		1977 Total		1978 Total		1979 Total	
	Getty's U.S. Prod.	U.S. Prod.	Getty's U.S. Prod.	U.S. Prod.	Getty's U.S. Prod.	U.S. Prod.	Getty's U.S. Prod.	U.S. Prod.
January	259.9	8,211	251.5	7,854	248.9	8,347	248.6	8,346
February	263.7	8,196	269.7	8,139	246.2	8,373	250.3	8,286
March	255.5	8,175	247.7	8,090	242.8	8,807	241.4	8,369
April	259.6	8,080	259.0	8,145	248.0	8,708		
May	257.2	8,168	251.2	8,075	244.3	8,801		
June	258.7	8,144	256.1	8,102	250.1	8,822		
July	252.2	8,104	249.4	8,105	249.8	8,747		
August	259.8	8,047	256.4	8,307	246.1	8,788		
September	259.9	8,185	254.1	8,480	253.3	8,787		
October	259.4	8,049	250.8	8,573	255.8	8,830		
November	260.3	8,043	252.8	8,579	260.4	8,728		
December	257.0	8,006	248.2	8,487	247.1	8,651		

As you can see, there has in fact been no unusual decline in Getty's production during the last few months of 1978 nor during the first quarter of 1979.

NOTE:

- U.S. production figures are per monthly Bureau of Mines Mineral Industry Surveys and DOE Energy Data Reports as summarized in the Monthly Energy Review.

- Getty Oil Company and Skelly Oil Company merged on January 31, 1977. The "Getty" production figures set forth above for the period prior to February 1, 1977, include Skelly Oil Company production.

Mr. ECKHARDT. The things that would tend to pull down the total supply of middle distillates would be as DOE has explained—and I use the general term—the decrease and availability of crude oil going to the refineries, of course.

There would also be the division in the barrel as between middle distillates and gasoline, and there would be the demand for gasoline, all of which would affect this proposition.

Mr. CLAPP. I might comment right now, if I could, that our refineries have run very close to capacity near to date. We are projecting they will run at or very near capacity for the balance of the year.

So, we have not been affected as much as other refiners by the crude oil shortages.

Mr. ECKHARDT. I see.

Therefore, you have been running at a normal rate?

Mr. CLAPP. Yes; very close to it.

Mr. ECKHARDT. We probably can obtain this information that you have already supplied to DOE, but perhaps you might also supply us with figures respecting the percentage of the barrel going to middle distillates and that going to gasoline and what your projected plans are with respect to the remainder of the year, similar to what I read out from Shell's report, that is, from Cities Service's reports.

Mr. CLAPP. I can make a general comment on that right now. We can furnish more detailed figures for the record.

Mr. ECKHARDT. That will be fine.

Mr. MOFFETT. Without objection, so ordered.

[See p. 95, for question 3 answer.]

Mr. CLAPP. Our refineries right now are yielding approximately 26 percent of crude input in middle distillates. Historically we have almost always maximized gasoline. Our refineries are gasoline producing refineries. We have always made all the gasoline we could at those refineries and have not normally swung between gasoline and distillate production seasonally as many other refiners have done.

We do have some capability to swing, perhaps 2 to 3 percent. I think our capability to swing is perhaps less than others.

Mr. ECKHARDT. The average refinery break is somewhere around 44 percent for gasoline and about 22 percent for middle distillates. Is that approximately correct?

Mr. CLAPP. I do not know.

Mr. ECKHARDT. How about yours?

Mr. CLAPP. Ours are currently yielding about 26-percent distillate. Whether that is above or below the average for the industry, I do not know.

Mr. ECKHARDT. Thank you.

Thank you, Mr. Chairman.

Mr. STANGELAND. Will the gentleman yield?

Mr. MOFFETT. The Chair will yield to the gentleman.

Mr. STANGELAND. I would question, then, what percent would be gasoline?

Mr. CLAPP. I do not have that figure with me.

Mr. MOFFETT. The Chair recognizes the gentleman from Tennessee, Mr. Gore.

Mr. Gore. Thank you very much, Mr. Chairman.

I found Chairman Eckhardt's questions intriguing and quite useful.

I think that in retrospect, now that we know what happened to domestic production, it is fair to say that the immediate aftermath of the turmoil in Iran was the worst possible time to remove, prospectively, controls on domestic oil. There is the old proverb about riding the tiger's back. He who rides the tiger's back cannot get off.

The U.S. Government chose to get out of the business of controlling domestic oil prices at a time when the world market was in turmoil.

It could have expected some withholding, pending the increase in prices that were promised. We have gotten away with one leg chewed off, to extend the metaphor, and we are hobbling through the summer without knowing what is going to happen this winter.

However, that appears to be an accurate word for "withholding." It may be the cumulative effect of hundreds of decisions made by individual producers in anticipation of higher prices later on, but the net effect is the same.

We had a very sharp drop in domestic production at exactly the time when the national interest would seem to have required an increase in domestic production, if it was at all physically humanly possible to make up for what we were having difficulty in purchasing on the world market.

I would invite your comments on that comment.

If not, I will go on to other questions.

Mr. Clapp. I do not believe we can intelligently comment on that at this time.

Mr. Gore. That is fine.

Mr. Eckhardt. Will the gentleman yield briefly?

Mr. Gore. Certainly.

Mr. Eckhardt. When we removed controls of crude oil at this time, we might be like the Republican fox. It chewed off one leg and is still in the trap. [Laughter.]

Mr. Gore. I do not know what to say, Mr. Chairman. [Laughter.]

Let me move right on to my questions.

The questions on special rule No. 9 are not moot. They are not moot for these reasons.

When we face the harvest in September, we may find these same agricultural demands that led to the imposition of rule 9 back in May.

Is that a fair assumption?

We have removed rule 9. Now farmers do not have any special protection or any kind of priority. I am not defending special rule 9. Do not get me wrong. It was administered in a very misguided way. It was designed in a misguided way. There was all certification and no reference to a base period. It was a nightmare.

But the circumstances which led to the imposition of rule 9 will recur, perhaps with a vengeance, in September. Is that fair to say?

Mr. Johnson. So far as Minnesota is concerned, it is occurring now. We have a vegetable harvest going on. We have had to give middle distillates to three canning companies. We have had to allocate gasoline to the harvest machines. We have the grain harvest starting in Kansas, Missouri, Texas, and starting north.

Mr. Gore. The corn planting may be over, but the wheat harvesting is in full swing in many areas, but the peak in demand triggered by the wheat harvest is not as high as the peak in demand that we just went through for the planting season.

The peak in demand that we will see in September, similarly, is not quite as high as it was in May and June, but it will be higher than the current agricultural demand by a significant amount.

My question, then, is this.

Mr. Johnson, you are saying that in Minnesota you are having the problems with farmers right now. But my question is this. In September, are we not going to face circumstances very similar to the ones that led in May to the imposition of rule 9 to begin with?

Mr. Dirks. In Getty's case, Mr. Gore, our product primarily, that is, our middle-distillate products in the Midwest, are sold through approximately 700 distributors.

Product changes hands at the terminal, that is, title to the product changes hands at the terminal, so we do not know or have access to where the ultimate end-user, that is, who the ultimate end-user of the product is.

Therefore, I cannot specifically answer your question.

Mr. Gore. We know nationwide from experience that there is a big peak in agricultural demand for diesel in September. Is that not true?

Mr. Dirks. That is true.

Mr. Johnson. Another attachment I have is a forecast that we did for July through December. It shows on a daily basis 1,000 barrels and shows agriculture in September. While August was 1.2 million barrels a day, or 1,000 barrels a day, rather, in September it goes to 13,000 barrels a day. In October, it is 7,200 barrels a day and in November 10,000 barrels a day.

So, that is an indication of exactly what you are saying, Mr. Gore.

Mr. Gore. I see.

The question I am getting to is this.

If we can sit here at the end of June and see this coming very clearly, and when we know that this peak on the part of farmers is going to come in September, and when we know with some certainty that in the month of September there is likely to be increased scrambling on the part of heating oil distributors when they realize how far short of the October 1 target that they are going to come up with, and when you see that truckers have a peak, then I wonder.

My understanding about the truckers is that it is relatively stable. Maybe that can be taken as a constant.

Then we face a situation in September where we are going to have to have either a reimposition of something like rule No. 9—hopefully designed and administered in a sensible and rational fashion, unlike the experience that we have just been through—or we are going to have to have a more extensive framework of allocation.

It just seems inevitable to me.

At the time that this was going on and while we are here, in Tokyo the U.S. Government is preparing to agree with the other major users to cut down the national use level. We have effective worldwide allocation.

Then, how can we have international allocation in a chaotic marketplace for distillates, as the most salient part of the market for this hearing, without an allocation system for diesel here in the United States?

It just seems inevitable to me, or it ought to be inevitable, that this decision is made to go back to allocation controls for diesel fuel. That should, at least, be on a temporary basis through the spring of next year.

Mr. JOHNSON. That is my point. I stress the fact that we have already committed to the international energy scene where we reduce our demand by 5 percent, or 1 million barrels a day. We will not hit that.

Mr. GORE. They say they have already met that target. That is 5 percent down from an ephemeral number. That is what the argument between the United States and France is all about. France says we have not done anything. We say we have dropped it 5 percent from a figure that is pulled out of the air.

The new commitments are apparently going to be real.

Mr. JOHNSON. To 1978 levels. If that is the case, and I got through telling you what our demand figures are, then in a couple of the segments there is nothing we can do about it.

At the present time we have 1.6 billion to 1.7 billion bushels of grain in storage, on-farm storage in country elevators. We do not know for sure, because we do not have any idea. The Agriculture Department does not know how much farmers put up.

But we know that we have to move 1 million bushels before November if we are going to have room for existing harvests or what we have in the ground.

We also know that 80 percent of the grain that is moved inside the State is moved with trucks, so we know that truck demand is there just to get the harvest out.

We have commitments with Russia. This has to be moved through the Great Lakes. There is no way that we see we are going to be able to cut that demand for trucks. It is tied in directly with agriculture.

We have the classic dilemma of one part of the Government saying we are going to fix the input level and we are doing really nothing with the demand side. We have encouraged farmers over the last 10 years to switch to diesel tractors. We switched to trucking which uses diesel fuel.

We have abandoned the rail beds. We have seven separate rail abandonments in Minnesota right in the middle of our primary grain producing areas.

The only viable railroad we have left is in bankruptcy right at the present time. Yesterday, it was announced that they would reduce service even more. That is because they do not have diesel fuel.

Mr. GORE. Mr. Johnson, you agree that we ought to go immediately to reimpose allocation controls, at least on a temporary basis, on diesel fuel?

Mr. JOHNSON. Yes.

Mr. ANDERSON. I agree also. There are several lessons that have been learned from special rule No. 9.

The error of that rule was not to allocate 100 percent to agriculture. The error is that it did not account for everybody else.

Mr. GORE. Yes; and it did not allow reference to any base period. It relied on oral certification.

Mr. ANDERSON. It takes a while for people to learn how to implement a rule. If we wait until the demand comes up in September, and try to deal with it on an emergency basis, we are bound to fail in September no matter how good the rule is designed. So, the time to implement full allocation controls is right now.

Mr. GORE. Mr. Dirks?

Mr. DIRKS. Mr. Gore, as I view our problem, there is very little discretionary use currently for diesel fuel and furnace oil, as opposed to another product, like gasoline.

Mr. GORE. Could you repeat that?

Mr. DIRKS. There is very little discretionary use of diesel fuel and middle distillates compared with gasoline, for example.

In other words, we do need the diesel fuel for agriculture. The truckers need the diesel fuel. The drillers who are drilling oil and natural gas will need the diesel fuel.

Mr. GORE. What about the industry? What about the boiler users? What about the people burning it under boilers?

Mr. DIRKS. I am talking about currently used.

Mr. GORE. There is a lot being burned under boilers right now. That is discretionary. I am talking about utilities and industry.

Mr. DIRKS. That is right.

I am not saying there is no discretionary usage for diesel fuel. I am talking about the basis as a comparison with gasoline.

I think it behooves us to concentrate our efforts on conservation, and particularly in the gasoline area.

Mr. GORE. I agree with that, but what is your response to the train of logic that I laid out for your leading to my conclusion that we are going to make a big mistake if we do not reimpose allocation controls on middle distillates?

Mr. CLAPP. I can say this. I think I speak for my company and myself. We have been hoping to avoid the reimposition of controls. Perhaps we have not done a very good job of avoiding it.

Mr. GORE. That is a fair conclusion to make, but go ahead.

Mr. CLAPP. In fact, I think our particular problems as a company have been due to the fact that we did not husband our available supplies very well this past spring. We are sensitive to criticism of withholding supplies from the marketplace in anticipation of higher prices, so we essentially sold more than we should have during the first 3 or 4 months of this year.

Now we find ourselves in a very much reduced inventory situation below minimum operating inventories in the Midwest. In order to rebuild those we are forced to go to an allocation system of our own.

Mr. GORE. Yes; I see.

You are in a similar position to Cities Service. Getty and Cities Service have been among the hardest hit on crude availability; right?

Mr. CLAPP. No; we have not been hard hit on that basis.

Mr. GORE. I apologize. Go ahead.

Mr. CLAPP. We have sold a lot more this spring that we did last spring.

Mr. GORE. I see.

Mr. CLAPP. We have installed an allocation system of our own for middle distillates——

Mr. GORE. In September when you get the farmers coming in, you will have the truckers with constant demand, and we are missing the targets on heating oil inventories. We will be moving harder there. The farmers come in and they say: "Look, we have to have it or we cannot harvest our crops."

Should we not go to allocation controls now in anticipation of that inevitable situation?

Mr. CLAPP. I think perhaps the Government can play a useful role here. I would like to see it be a role of setting overall policies and goals and priorities as opposed to a lot of very detailed regulations.

Mr. GORE. Does that mean no?

Mr. CLAPP. That is a qualified yes.

Mr. GORE. So, you would like to see us go to allocation controls? Do you think it would be wise?

Mr. DIRKS. We are currently allocating product to our customers. As a matter of fact, we are dispatching product on a load-to-load basis to insure an equitable distribution to our customers.

We feel that we have the knowledge in the marketplace and we have the knowledge of our customers and of weather conditions and so on. We have the prior year purchases. We can do this.

Mr. GORE. But we have snipers on the interstate highways.

Mr. DIRKS. I am speaking for Getty Refining & Marketing Co. and the system we are using. I feel our system is adequate.

Mr. GORE. In conclusion, let me say this.

Let me get a response. Do you, or do you not, think it would be wise for the Federal Government, in anticipation of the problems in September and beyond that in January and February, to move now to the reimposition of allocation controls on diesel?

Mr. DIRKS. Full control as we had in June 1976, or whatever the cutoff date was?

Mr. CLAPP. Are you asking if we think we should go to reimposition of the allocation controls as they existed prior to June 1, 1976?

Mr. GORE. Or some version thereof.

Mr. CLAPP. I do not think we could recommend that you go that far.

Mr. GORE. What about allocation controls without price controls?

Mr. DIRKS. We are currently under price controls.

Mr. GORE. Not on distillates.

Mr. DIRKS. So far as the Council on Wage and Price Stability is concerned, we are under price controls.

Mr. GORE. Well, I do not know. The Council on Wage and Price Stability is 7 percent a year. It is now at an annual rate of 48 percent a year. [Laughter.]

So, you are not doing too well.

Mr. DIRKS. We are complying with that.

Mr. MOFFETT. The product prices?

Mr. DIRKS. Overall, yes.

Mr. GORE. You are talking about your margin, perhaps.

Mr. DIRKS. Yes.

Mr. ECKHARDT. Will the gentleman yield?

Mr. GORE. Yes; I will yield.

Mr. ECKHARDT. We heard from Cities Service that the price of diesel now is approximately 55 cents. I think they last said 55 cents, but they agreed with me that the price on the average is around 60 cents a gallon. Of course, as we demonstrated during the last couple of years, it has been around 36 cents.

Can you tell us what the price from Getty is with respect to the wholesale price on diesel fuel?

Mr. DIRKS. Our terminal price at El Dorado, Kans., the location of our refinery, is either 56¼ or 56½ cents per gallon. I do not recall which. It is in the area of 56 to 56½ cents per gallon.

Mr. ECKHARDT. How are you, in any way, restrained in setting that price by any Government regulation?

Mr. DIRKS. We are restrained, as I understand it, again by the Council on Wage and Price Stability.

Mr. GORE. The voluntary guidelines?

Mr. DIRKS. Yes.

Mr. MOFFETT. Energy is exempted.

Mr. DIRKS. I am not an expert on this. There are certain guidelines for the oil industry, I believe, that apply only to the oil industry.

Mr. GORE. Let me go back to my question. What about allocation controls without price controls? Do you think that would be in the national interest and wise?

Mr. MOFFETT. I believe the gentleman said that he would not support that.

Mr. GORE. He said he would not support the full panoply that we had in July 1976. I am subdividing the question.

What about allocation controls without price controls?

Mr. DIRKS. No, sir. I do not agree with that.

Mr. GORE. Thank you, Mr. Chairman.

Mr. MOFFETT. One of the things the gentleman is bringing out is that you are saying you have confidence in your own system to work but you do not know about other systems. The problem is that we have the gaps that we find in between. That is where the snipers and blockades and the harvest problems occur. The harvests are waiting to be trucked off without the diesel fuel coming in. It is the gaps that we are looking at.

Mr. Stangeland?

Mr. STANGELAND. I thank the chairman.

First of all, let me welcome my fellow Minnesotan, Mr. Johnson, here, and commend him on an excellent bit of testimony.

I have a few questions.

Mr. Johnson, what has been the Department of Energy's response to your request for 25,000 barrels a day to build up your stocks of winter heating fuel?

Mr. JOHNSON. Deafening silence.

Mr. STANGELAND. How long ago was that request made?

Mr. JOHNSON. The 15th of June.

Mr. STANGELAND. I am curious about a couple of things. Let me get away from middle distillates a bit.

I read, about a month ago, that our gasoline stocks on hand in Minnesota were 29 percent above a year ago. I have seen that reaffirmed a couple of times. I have seen the statement made that our consumption of gasoline is up about 4 percent.

I am wondering if that is the case and if we had no problem with availability of gasoline last year at the filling stations, why are we having the problem in Minnesota this year?

Mr. JOHNSON. Because of the allocation fractions. The primary storage——

Mr. STANGELAND. These allocation fractions now that you are talking about; are they federally mandated allocations?

Mr. JOHNSON. The requirement on the part of the DOE that everybody within the service area be treated equally. So if they are servicing three States out of a refinery, they give everybody the same fractions.

We just happened to have primary storage because we have those refineries in the States.

I mentioned that two of them have not gone down yet. When they go down, those stocks will disappear. That represents 15 days' supplies for Minnesota.

Mr. STANGELAND. The 29 percent in storage over a year ago does not belong to Minnesota?

Mr. JOHNSON. Some of it will go out through the traditional marketing patterns of those two refineries.

Mr. STANGELAND. The reason I bring this out is that I am not too sure that the Federal Government has expertise or the ability to make the allocations and make them fairly and properly. I say that to Mr. Gore.

I do not think the bureaucrats in Washington know when we are harvesting wheat or shipping wheat or digging potatoes or whatever we are doing. I do not think they know.

Mr. GORE. Will the gentleman yield?

Mr. STANGELAND. Yes.

Mr. GORE. I know that you represent a lot of farmers. I represent a lot of farmers.

When they come in and say that they cannot get the fuel in September, then I wonder. In west Tennessee, in spite of rule 9, we had farmers who simply could not get any fuel.

When they come in in September and say that they cannot get it, what are we going to do? Do we leave them at the mercy of the black market? Are they going to have to pay $1.40 a gallon for diesel fuel? Do not those circumstances justify some role on the part of the Government to make supplies available on some fair basis?

Mr. STANGELAND. I would agree with the gentleman and not disagree, but I am wondering if they have the competence and the ability to do it. I am questioning that.

Mr. GORE. It certainly is subject to question. I would share in the gentleman's skepticism. My skepticism is only exceeded by my skepticism on the ability of the oil industry to make those judgments on a fair and equitable basis.

I thank the gentleman for yielding.

Mr. McCloskey. How about the Congress? [Laughter.]

Mr. Stangeland. I had occasion to visit with a co-op oil company in Dumont, primarily supplying agriculture, with about 98 percent of their sales being to farmers.

They had Farmland Industries as a prime supplier. They lost a great deal of the allocation. The allocation was taken away. This co-op had to go out on the market and buy from Koch Co. They were paying anywhere from 10 cents to 14 cents a gallon more than what the prime supplier was supplying him.

What is the reason for that? Is Koch buying on the spot market, or is it paying more for the product than anyone else in order to have that product?

Mr. Johnson. That is exactly right. They lost their Alaskan contract at the end of May. It expired and they were unable to renew it, so they were out on the spot market.

Mr. Stangeland. Last Sunday this was brought to my attention. A bulk distributor dealer in Harding was bidding and had to bid against Koch to supply middle distillates to some large volume users in his vicinity, I would expect to the schools, the hospital, or something.

Koch would bid that contract for less than what this gentleman could buy from Koch. Is there an explanation for that?

Mr. Johnson. I do not understand Koch because they do not have a retail or marketing arm.

Mr. Stangeland. His explanation was that Koch was doing the supplying direct to that volume purchaser at a lower price than what he could buy himself from Koch to distribute to his customers.

Mr. Johnson. I will check it out, but they are not a retailer.

Mr. Stangeland. It puzzled me. That is why I would like to have an answer for it.

We went through two of these things. I heard the chairman discuss the severity of the winter in the Northeast last year. The last two winters in Minnesota—and I would guess maybe in Montana also—were probably the most severe we have had in many a year.

I have been looking forward to the January or February thaw. For 2 years in a row we have not had that. They have been severely cold.

Is that the prime reason? Is that where the bulk of the 5-million-gallon shortfall comes from in Montana?

You cite the late season. Both of you do. I am a farmer and I know that late seasons can cause problems.

However, as you look at the history of agriculture, we find more one-time passes now rather than going over a field two or three times in preparing for planting in the spring.

I would guess that per acre the consumption of diesel fuel in agriculture has gone down as a matter of rule. You have larger equipment that burns substantially more fuel. But it covers more ground.

There is the fact that the tillage practices are one-time over rather than two or three times over. I would guess the shortfall is primarily because of the severe cold of the heating season and not so much because of the late agricultural planting season; is that correct?

Mr. ANDERSON. I think the contrary is true in Montana this year. The per acre consumption of fuel is up because of the cold weather.

For example, there was a substantial kill because of a late frost of Montana winter wheat. It had to be replanted and we essentially had to use twice as much fuel to get the crop in the ground.

In addition, there was a soil moisture problem that required more working of the soil in many areas. This year agricultural fuel demand is up because of the cold weather.

Mr. STANGELAND. I can understand if you had a freezeout on the winter wheat and had to go over the ground again. It is obvious that you would have some increase.

However, it would seem to me that we have not had an increased consumption per acre. We only have so many acres. We do not get more acres per year.

I have one question for the Getty people.

Could you estimate the cost of implementing special rule No. 9 for your company, that is the labor costs and the paperwork?

Mr. CLAPP. Let me consult with one of my colleagues who may have some of that information.

Mr. STANGELAND. Why do you not just submit it for the record?

Mr. CLAPP. Yes; we will try to come up with an estimate and submit it later.

Mr. ECKHARDT [presiding]. Without objection, so ordered.

[See p. 95, for question 4 answer.]

Mr. STANGELAND. I have no other questions, Mr. Chairman.

Mr. ANDERSON. Excuse me. May I respond to your concern about Federal bureaucrats being able to allocate fuel?

That is a point well taken, but I think if the allocation scheme is based on the base periods which reflect the historical use of fuel, then the bureaucratic discretion is held to a minimum.

Mr. ECKHARDT. Mr. McCloskey?

Mr. MCCLOSKEY. Thank you, Mr. Chairman.

It is nice to have State bureaucrats to talk with. [Laughter.]

Mr. Johnson, I note that in Minnesota you had a 22-percent increase in 1 year in the use of distillates. That parallels something I criticized in my own State.

We had a 9 percent per capita use of gasoline increase last winter in a 6-month period. The only way we could figure it out was that suddenly after 2 years of drought we had a great snow season and everybody went skiing in California.

You are one of the great agricultural producing States. As a Minnesota bureaucrat, could you tell this subcommittee, how that 22 percent increased in 1 year?

Mr. JOHNSON. It is primarily the result of having two very good harvests in a row and very low prices. There was an awful lot of grain stored that started to move last fall. After the harvest it had to move and it continued right through the winter.

Part of it was the Russian contract. We see truck movements are up substantially at the various ports. We have checked that through the Department of Agriculture in the State.

Mr. McCloskey. So the economy has essentially benefited immensely by the same things that caused the demand for fuel increase?

Mr. Johnson. That is right.

Mr. McCloskey. Mr. Anderson, if we had allocation, as you recommend, so Montanans got a fair allocation, would you be confident the Montana bureaucracy could allocate fairly amongst Montanans?

Mr. Anderson. I do not suggest that the Montana bureaucracy should determine the allocation fractions for all sectors of our economy, but rather that they be based on historical use.

Mr. McCloskey. Did you understand my question?

You are suggesting the Federal Government, and its bureaucracy, allocate as amongst States; am I correct?

Mr. Anderson. No; I am suggesting the allocation be based on historical use.

Mr. McCloskey. That is amongst States; is it not? How do we allocate? We do not allocate among industries, do we?

Mr. Anderson. You essentially allocate it among jobbers. The jobbers have historical accounts for all of their customers.

Mr. McCloskey. How would you want us to do that?

Mr. Anderson. By establishing a base period for those distributors.

Mr. McCloskey. What would you do in the case where you had a cold winter in Montana or a big harvest in Minnesota?

Mr. Anderson. In that case I think something like the State set-aside program can be used to take account of those State or regional variations.

Mr. McCloskey. Let me put you to a test.

It is a privilege here when in Washington we have representatives from States. It is true, I think, that the Federal bureaucracy very often does not understand what is happening out in individual States appearing before us.

Let me put you to the test and have you specify, in a written communication to this committee, which will be included in this hearing record, precisely how you would solve these problems and what kind of simple rules you would have to have adopted.

Let me put that to the Getty people also.

[See p. 96, for question 5 answer.]

Mr. McCloskey. I think business has a particular right to object to the complexity of regulations drawn in Washington. Part of the reason for the complexity and what appears to be insensitivity in those regulations, has to do with the fact we never receive the constructive recommendations from industry as to how simple regulations should be drawn.

Business, it seems to me, for the last several decades, has responded after the fact with fear, loathing, horror, and anger, but we do not get any constructive recommendations from business before the fact as to what should be the case.

Let us take the standby rationing plan the President has proposed and the Congress voted down. Would it not be worthwhile now to have some prospective input from both business and the State governments as to what kind of a rationing plan they think should go into effect if we have a 20 percent cutoff? Congress has mandated that.

Has the State of Minnesota given attention to what kind of a rationing plan you want?

Mr. JOHNSON. Yes.

Mr. McCLOSKEY. Have you submitted it to us?

Mr. JOHNSON. No, we are debating it within our own agency and the State government.

Mr. McCLOSKEY. Is it a fair request for me to make of you that within 60 days we could have the State of Minnesota's specific input on the long-term rationing program?

That is also the responsibility of this committee.

Mr. JOHNSON. Yes.

Mr. McCLOSKEY. Mr. Anderson, how about Montana?

Mr. ANDERSON. We would be happy to do that.

We would also be happy to supply our opinions on a wide variety of other specific issues. The problem has been our inability to fund the staff necessary to do this.

I gave the example of our State set-aside program. This program has been operated over the last 5 years ever since the Arab embargo by one man. He has been able to do it satisfactorily. The number of requests has been within his manageable capability.

In addition, he has been able to keep track of the Federal regulations and comment appropriately as they affect Montana.

Recently, however, because we have been unable to handle the volume of requests, we have considered transferring this gentleman to the department of institutions because he has been going crazy. [Laughter.]

Mr. McCLOSKEY. You have one of the great innovative States with regard to its educational system. We find Californians have to go to Montana to college. I would think in that reservoir of human talent there could be found within the State some constructive suggestions to the rationing plan.

Mr. ANDERSON. Indeed, there is a lot of talent there, but it is questionable whether that talent is sufficiently informed and educated on these complex issues in order to intelligently comment.

Mr. McCLOSKEY. I valued your testimony and particularly your recommendations. I just hope that you can recognize that our ability to translate them into precise and simple laws would benefit if you could give us precise and simple recommendations.

Mr. ANDERSON. We would be happy to do that.

Let me add as a footnote this. I was disappointed to learn when I got here last night that my fuel allocation officer has resigned. He has simply become unable to personally cope with his job. We now have no one in the State government who has the experience over the years of operating in this set of issues.

Mr. McCLOSKEY. I had that worry last night that I was becoming wholly unable to cope with my job. [Laughter.]

Mr. ANDERSON. Did you resign? [Laughter.]

Mr. McCLOSKEY. There have been some suggestions to that effect. [Laughter.]

Mr. ECKHARDT. Prior to the removal of allocation of price controls on middle distillates on July 1, 1976, we had considerable discussion of that question on the Committee on Energy and Power with who was, at that time, the counsel for that committee and who is now the head of FERC, Mr. Charles Curtis.

Some of us felt, and we were considering the question, of at that time removing allocation and establishing another kind of price control. As you know, allocation and price control, as they apply to gasoline and as they applied to middle distillates at that time, were related to particular contracts and particular supplies and particular recipients.

Therefore, the then administration contended that price control could not be had without allocation control.

There was the question of whether or not some kind of a ceiling price could be established, derived from a high average or some other derivation at that time.

At that time, we were advised, I think, by our staff, and we came to the conclusion that it could probably be done, but that it probably would not be practical with an administration that did not want to make it work.

So, ultimately what happened at that time was the removal of both allocation and price control. Of course, the situation was at that time almost the opposite of what exists today.

Inasmuch as there was an adequate supply of crude oil, the tying of particular purchaser to a particular supplier created something of the same situation that exists in a monopoly situation. There was no way to go into the market and get the best possible price. There essentially was no competition.

At that time it was argued that the removal of allocation control and, of course, price control along with it, would, in effect, bring down price.

I cannot see much evidence that that actually happened. Of course, in the meantime an entirely different situation exists. This is the situation in which, No. 1, there is a dire shortage of gasoline now and the purchase of oil in the spot market is at a very high rate.

Of course, as you yourself have pointed out—and I think as has been agreed by the producers, that is, rather the refiners—there is the necessity of doing something about a supply of diesel oil and No. 2 fuel oil at some later time.

I think there may be a difference as to how that should be addressed.

Mr. Clapp, Mr, Dirks, and some of the other witnesses have indicated that it ought to be taken care of by industry's restraint and in its planning and in its own allocation. Some of us feel, that we should go farther in this direction with respect to some kind of Government operation.

However, let me address this question of price. We have not really talked about that yet. If there has been an extreme demand for gasoline now, and gasoline prices have shot up in spite of our control of product prices, what is going to happen without planning and without a determination with respect to allocation to diesel oil prices in the fall and winter of this year?

Do you have any comments on the question of price?

Mr. JOHNSON. Thirty percent of our homes in Minnesota are heated with oil. I think we are going to see a doubling of last year's heating oil price and probably a lot of new welfare clients, people who just do not have the flexibility to deal with that kind of a price increase.

However, I think we have to separate that segment, or that problem, from the other problem of supply and demand. That problem—I do not think I am adequately staffed or have the adequate understanding to understand the welfare concerns. I am oriented toward the supply and demand and conservations. Obviously we impact on that through the weatherization and other conservation efforts.

However, I try to keep those two separate, but there is no question in my mind that there will be $1 heating oil this year in Minnesota.

Mr. ECKHARDT. We have had a movement from approximately 36 cents per gallon for diesel fuel running though a number of years, that is, of wholesale price, until the beginning of this year. Then we have had to jump to about 41 cents and now about 60 cents. That, I think, is not taking into account the average price, including the spot price on the market, which is, in many instances, around a dollar at the present time.

Therefore, what we are talking about is the contract price now as compared with the contract price in the past, but the contract price in the past was essentially the average price because most diesel fuel was sold under contract.

The spot market is moving into this area as there is a shortage.

I am very concerned as to whether or not we should not simply go back to the regulation that existed before July 1, 1976. I also have some pretty serious doubts as to whether or not you can institute only allocation without doing something about the price. Of course, you hope that your allocation will be to those who use it, but there also may be some brokering between those to whom middle distillates are assigned.

Do you not have some concerns about this question of price?

Mr. ANDERSON. We have great concerns, Mr. Chairman. I think allocation can only work if prices are controlled along with allocation.

Mr. ECKHARDT. That is the other side of the coin as to what the Ford administration told us in 1976 with respect to the removal of allocation controls. They said that it could only work to have both in effect and that you could not continue price control when you removed allocation control.

I think that may not be altogether true on that side of the coin, inasmuch as there could be some restraint with the ceiling price.

It does seem to me that there is every reason why we ought to control price as well as allocation at this time with respect to middle distillates.

Mr. ANDERSON. We certainly agree. The alternative that you mentioned of simply going back to the system that was in effect prior to July 1, 1976, makes the most sense at this point because the system is familiar to the companies and to the State and Federal agencies.

In fact, many of the oil companies still have that allocation system virtually in effect.

Mr. ECKHARDT. In some of the questions that I directed to the previous panel, I may have reflected—and I certainly wanted to reflect—this concern.

If we utilize the oil now flowing for the purpose of making gasoline, that is, if we break the barrel in favor of gasoline, or at least not in favor of middle distillates, and if we then have to double up and catch up—as Arco was suggesting—toward the late fall and winter of next year, then we may also be using crude stocks which are more expensive at that time, than the crude stocks from which we are now producing gasoline.

We know, No. 1, that OPEC is talking about an increase anywhere from $18 to $22 per barrel. We also know that they are not necessarily in agreement among themselves as to the constant price, so we may come out with an $18 price from Saudi Arabia and a variety of prices above that from other Arab countries and a makeup of the shortage in the spot markets that are presently running as high as $35 or $36 a barrel.

What concerns me is whether or not we may be making up our crude stocks from which we are going to have to produce a lot of our middle distillates from higher priced oil than that oil which would be used today if we tilted more toward diesel fuel.

Mr. JOHNSON. I have an even more logistical answer than the one you gave. It is an impossibility, so far as Minnesota is concerned.

In my prepared testimony, I said our refineries have been optimizing distillate and that they are running flatout. We have every assurance that they have sufficient crude, including the Canadian contracts, to be able to continue at that pace.

They provided about 50 to 60 percent of what we burn in the State.

That means that we are dependent upon the product lines for the rest.

There is extra pumping capacity of about 40,000 barrels a day today. I am asking that 25,000 of that 40,000 start the first of July for Minnesota. You can see very well that if we waited until November, we will never catch up. There will not be the capacity. That assumes that nobody else over there has no other reason for that capacity to be taken up in the Williams' system, which obviously is not the case. Everybody has the same problem.

Mr. ECKHARDT. Then you both would have a shortage and you would have the resulting impact on price because price is not controlled with respect to the middle distillates; would you not?

Mr. JOHNSON. That is correct.

Mr. ECKHARDT. The worst of all worlds, then. You would not have enough of it and what you did have, could be at an inordinately high price.

Mr. JOHNSON. Correct.

Mr. ANDERSON. Would it be inordinately high? If you compare petroleum prices with the prices of other energy forms, it makes a lot of sense from an economic point of view that all of those things be compared on an equitable basis, that is, that the real marginal cost of oil be compared in the market place with the real marginal cost of its competitors. Its competitors include solar and conservation and other options that have some environmental advantages.

Mr. ECKHARDT. There is very little demonology in my political approach. I do not like to think that people necessarily work out devices by which they are affecting adversely our society merely because of a vicious intent.

At the same time, I cannot help but recognize that there are some economic incentives for persons to act in a certain way.

I seem to see in this whole situation an extreme demand for gasoline at this time which has run the price of gasoline up. The supplying of that demand breaks the barrel fairly favorably toward gasoline at this time.

However, in the long run, as Mr. Dirks has pointed out, there is an extremely inflexible market with respect to the middle distillates.

Of course, I agree with Mr. Gore of Tennessee that there are some areas in which you could switch from middle distillates to other things, but that does not affect the immediate market. That calls for an actual economic change in plan.

At any given period of time, however, the middle distillate market, I think, is very fixed. If there is a shortfall in that market, it would seem to me that even a small one can really move prices up extremely high because diesel fuel has to be gotten at any price. To a large extent, the same thing would be true, particularly in your cold climates with respect to No. 2 fuel oil.

Therefore, are we not seeing a situation with the best of both worlds that are being achieved by the oil suppliers? One, there is considerable pressure on upward price and upward demand for gasoline now. During this fall and this summer, unless there is assurance to the consumers that there is going to be enough diesel fuel and No. 2 fuel oil, it seems to me there will be an inordinately high price at that time.

I have made these remarks and somewhat addressed them to oil producers. Perhaps critically, Mr. Dirks and Mr. Clapp would like to comment.

Mr. DIRKS. Mr. Chairman, as I stated before, we are, and have been under, price guidelines under the former Cost of Living Council. That has been since 1971.

Mr. ECKHARDT. Do you think you can assure us that diesel will not go to, let us say, on the contract market to 75 or 85 cents by the end of this year?

Mr. DIRKS. I cannot assure you that; no.

That price will be a function of whatever happens in the crude oil market between now and then.

Mr. ECKHARDT. It will be determined largely by demand; will it not? It will be a demand price, primarily and not a cost-push price; will it not? Is that not true?

Mr. DIRKS. In our case, I would suggest that it would be more of a cost increase, crude oil cost increase, as opposed to a demand.

This is because of our compliance with the voluntary wage and price guidelines.

Mr. ECKHARDT. These guidelines, as I understand them, are applicable with respect to the whole industry, that is, the refining industry, and they are not directed at the price of the product.

Therefore, actually the product price itself is going to be determined just as any uncontrolled price in the market place is determined. Is that not true?

Mr. DIRKS. Yes; I believe that is correct.

Mr. ECKHARDT. In what way is it not correct? Or, would you modify it?

Mr. DIRKS. Let me call on our attorney who handles this matter, Mr. Gervino.

Mr. ECKHARDT. Certainly.

We had better put you under oath. I do not know whether you have already been sworn or not.

Do you solemnly swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. GERVINO. Yes, I do.

I would like to clarify one thing.

I handle the DOE regulations. I am not really familiar with the Council on Wage and Price Stability, but there is a general overall guideline imposed. I believe there are various tiers and various guidelines and objectives that you do have to meet.

Mr. ECKHARDT. If you do not meet them what happens?

Mr. GERVINO. Outside of losing Government contracts, I really do not know. As of yet, it has not been in effect that long. So, I would not know that.

Mr. ECKHARDT. You are considered a bad citizen if you do not follow them; is that not right?

Mr. GERVINO. I am sure it would be more than that. [Laughter.]

Let me say this also, Mr. Chairman.

The spot price right now of middle distillates—excuse me. Mr. Clapp, do you have any idea?

Mr. CLAPP. Yes; the spot price of middle distillates has risen to just about the same extent as the spot price for gasoline. The gasoline at one point——

Mr. ECKHARDT. About a dollar; right?

Mr. CLAPP. About $1.25 to $1.30, at which point distillates were $1.15 or $1.20.

Mr. ECKHARDT. When did gasoline get to $1.30?

Mr. CLAPP. On the spot market.

Mr. ECKHARDT. Who buys that on the spot market?

I have paid an awful lot for gasoline, but I have never come anywhere near that price. I understand there was one fellow in one of the Eastern States who was selling it for $1.50. Maybe he was the spot market. [Laughter.]

He was also put on the spot. [Laughter.]

He was, in fact, violating a regulation that still exists. We have not deregulated gasoline allocation or pricing, although many people cannot discern the difference between regulation and deregulation in this respect.

Mr. GERVINO. If we assume that the spot market on middle distillates is up to $1.10, we are considerably less than that. We have been. So, we do not have to wait for the winter. Right now we could theoretically go up 40 cents.

Mr. ECKHARDT. That is right.

There is nothing illegal about doing that, but there would be something illegal about going up to that price with respect to gasoline.

Mr. Gervino. There is nothing illegal about that and a lot of other actions that we could take.

The point I am trying to make is that we have not done that. That is not the controlling factor.

The controlling factor in our case is the crude oil cost increase. That is the only point I am trying to make.

Mr. Eckhardt. Not a governmental regulation that limits price.

Mr. Clapp. Right. In other words, our distillate prices have gone up to about the same extent as our gasoline prices over the same period of time. These have been tied primarily to crude cost increases.

Mr. Eckhardt. Actually, of course, diesel prices, when we talked about a spot market, we are talking about truckers actually having to pay, when they are on the highway, a dollar a gallon for diesel as a practical matter.

This is not just a rare occasion. It is becoming a rather usual situation for the independent truckers; is it not?

Mr. Clapp. I do not know, Mr. Chairman.

Mr. Dirks. Mr. Chairman, I do not have any price surveys so far as the retail price of the product is concerned at truck stops. But I have read this also. I have read this in the papers.

Mr. Eckhardt. I have not seen that happen to anything like that scale with respect to gasoline.

Do you know of any place or any locality in the country where I have to pay a buck for gasoline?

Mr. Dirks. In New York City it is approximately a dollar per gallon.

Mr. Eckhardt. Gentlemen, this has been most helpful to the subcommittees. We want to thank you.

We intend to proceed tomorrow with the governmental agencies on this subject.

The subcommittees stand adjourned.

[Submissions to subcommittee questions 2 to 5 referred to on pages 74, 77, 86 and 87 follow:]

QUESTION 2. What percentage of its own domestic crude oil does Getty run in its own refineries?

Getty uses approximately 7.32% of its own domestic production in its refineries.

It should be noted, however, that Getty exchanges some of its own domestically produced crude for domestic production of other companies which Getty runs through its El Dorado, Kansas refinery. The above percentage does not include any crude so obtained.

QUESTION 3. What is the percentage yield of gasoline and middle distillates at Getty's refineries?

(a) What is Getty's planned yield for the remainder of the year?

At our El Dorado, Kansas refinery the average percentage of a barrel of crude oil converted to gasoline during the first six months of 1979 was 55.8% and the average percentage of a barrel of crude oil converted to middle distillates during the period was 25.2%

For the last six months of this year it is estimated that the average percentage yield will be 56.2% for gasoline and 26.7% for middle distillate at this refinery.

At our Delaware City, Delaware refinery the figures are 56.5% for gasoline and 31.4% for middle distillates for the first six months of 1979, and 53.9% and 33.5% estimated, respectively, for the last six months of 1979.

QUESTION 4. How much did it cost Getty to implement Special Rule No. 9?

Although we did not keep specific records indicating what it cost Getty to implement Special Rule No. 9, it is estimated that the cost to Getty to implement the initial Rule, for the brief period of time it was in effect, was in excess of $100,000.

However we cannot estimate what it cost our customers and the ultimate consumer not only monetarily but in terms of disruption of their business, hardships endured and in many cases anxiety over their future livelihood.

It should be noted that in Getty's case the implementation of the Rule actually resulted in Getty being compelled to completely cut off the supply of middle distillates to all of its customers in its Central Region except for those customers that could certify they needed the product for agricultural production.

QUESTION 5. What precise simple system would Getty recommend to solve the middle distillate supply problem for all customers?

As long as middle distillates are in short supply, and there is a significant difference between the total amount of product required to satisfy customer needs and that which is available for distribution, there is no simple system that can be adopted which would solve this basic problem. Nor is there any simple system which in and of itself will satisfy everyone under such conditions.

However, it is Getty's position that, in general, a company's own voluntary allocation program is better than a government imposed and administered program for two basic reasons.

First of all, the oil companies have individuals working for them who are not only more familiar with the oil industry in general but said individuals are obviously much more familiar with the problems of supply, distribution, etc., associated with the operations of their own particular company.

Secondly, absent strict government regulations, an oil company will retain the flexibility to react quickly to changing conditions and emergency situations and to take immediate action when it is needed.

It should be obvious that every supplier has its own unique marketing and distribution network which has evolved over the years the company has been in existence. As an example; the number, size, configuration and location of bulk plants and terminals vary from company to company as does a company's access to product (i.e., proximity to pipelines and waterways, ability to enter into certain specific exchange arrangements, and so forth). The "customer-mix" or concentration of particular types of customers served by a supplier also varies from supplier to supplier. Consequently, no single general allocation regulation imposed by the government can adequately make provision for the efficient and equitable distribution of product by suppliers when in the very nature of its operations one company differs from another.

As indicated in our response to question #4, Getty's own case is a classic example of where DOE's blanket "remedy" actually made the situation much worse for a great many individuals. Whereas prior to the enactment of Special Rule No. 9 Getty had a voluntary allocation program in effect under which all of our customers were receiving product on a non-discriminatory basis, satisfying most of their needs, the enactment of Rule 9 suddenly forced us to completely cut off the supply of middle distillates for all uses other than for agricultural production.

Currently, Special Rule No. 9, as amended, basically only requires that ground mass transportation receive 100% of current requirements. Getty has mass transportation demand which takes only a small portion of its supply. Getty has once again instituted its own voluntary allocation program for middle distillates in order to distribute the balance of its product each month.

We believe our particular program is best suited to our customers' needs and is an equitable one under the current conditions - given the fact that product is still in short supply.

In conclusion, it is our position that the additional knowledge possessed by those individuals who work within the oil industry day in and day out, coupled with the flexibility required to adopt a program compatible with the demands made of a particular company and the flexibility needed to react quickly to certain situations is vastly superior to any government imposed and administered program.

[Whereupon, at 2:10 p.m., the subcommittees adjourned, to reconvene at 10 a.m., Friday, June 29, 1979.]

DIESEL AND HOME HEATING OIL: PRICE AND SUPPLY ISSUES

FRIDAY, JUNE 29, 1979

House of Representatives, Environment, Energy, and Natural Resources Subcommittee of the Committee on Government Operations, and Subcommittees on Energy and Power and on Oversight and Investigations of the Committee on Interstate and Foreign Commerce,

Washington, D.C.

The subcommittees met, pursuant to notice, at 10:03 a.m., in room 2154, Rayburn House Office Building, Hon. Bob Eckhardt (chairman of the Subcommittee on Oversight and Investigations) presiding.

Members present from the Environment, Energy, and Natural Resources Subcommittee: Representatives Toby Moffett (chairman), Peter H. Kostmayer, Robert F. Drinan, and Paul N. McCloskey, Jr.

Member present from the Energy and Power Subcommittee: Representative Richard Ottinger.

Members present from the Oversight and Investigations Subcommittee: Representatives Bob Eckhardt (chairman, presiding), Albert Gore, Philip Sharp, Clarence Brown, William Danneymeyer, Norman Lent, and Marc Marks.

Staff present from the Environment, Energy, and Natural Resources Subcommittee: John R. Galloway, staff director, Cathy Hurwit, energy policy adviser, and Steven J. Engelmyer, counsel.

Staff present from the Oversight and Investigations Subcommittee: Richard Frandsen, counsel, Stephen F. Sims, special assistant, and Jay C. Shaffer, counsel.

Staff present from the Committee on Government Operations: Catherine Sands, minority professional staff.

Staff present from the Committee on Interstate and Foreign Commerce: Michael J. Stewart, minority counsel.

Mr. Eckhardt. The meeting of the various subcommittees will commence. As our leadoff witness today we welcome Deputy Secretary of Energy John O'Leary. Yesterday, testimony received by our subcommittees from U.S. refiners and State energy officials highlighted the fact that we as a nation are facing a critical shortage of diesel fuel and home heating oil.

One major refiner, the Atlantic Richfield Co., testified that, based on its forecast of industry operations for the remainder of the summer, a national inventory level of only 190 to 200 million barrels of distillate fuel oil will be achieved by October 1979. This is some 45 million barrels short of the 240 million barrel inventory target level which the Department of Energy indicated was necessary to insure heating oil supplies for the winter heating season. We will review the DOE projections with Mr. O'Leary and the need for mandatory Federal actions to increase distillate production, such as refinery yield orders or allocation of crude to refiners willing to process it.

On the other side of the coin from production is demand. An energy official told the subcommittee yesterday that demand for distillate in the State of Minnesota in the first 4 months of the year was up 22 percent over last year. Nationwide demand has also been above 1978 levels in recent years. A national program to control demand for middle distillates, as well as gasoline, is clearly called for. The Congress and the administration cannot delay any longer in affording, in place of a mad scramble for gasoline, a fair and effective gasoline rationing plan.

With extremely strong demand and sufficiently short supplies, prices of distillates, along with gasoline, are threatening to go through the ceiling. The subcommittee has seen evidence that the average heating oil prices in New England in the last 6 months have risen approximately 40 percent. This surge could add as much as $300 to the average homeowner's yearly heating bill. The subcommittee was told that the price of home heating oil in the Upper Midwest would reach $1 per gallon this winter.

To check unrestrained price increases and equitably distribute supply, we are most interested in hearing from Mr. O'Leary as to why it is not now desirable to reimpose the system of allocation and price controls for middle distillates which were in effect prior to July 1976.

Following Mr. O'Leary's appearance, the subcommittee will hear from a meteorologist and a representative of the grocery manufacturing industry.

Mr. Moffett, do you have an opening statement.

Mr. MOFFETT. Thank you very much, Mr. Chairman.

I thought yesterday's hearing was excellent, but I found the testimony to be extremely disturbing. We were told that there is a very real likelihood of 3- and 4-day outages in New England of heating oil, outages meaning the point of time when the terminal operators' tanks are dry; we were told there is a very real possibility of midnight deliveries where customers would get very small amounts of heating oil to get them through the night and the next day.

Secretary Schlesinger was on the morning news from Tokyo this morning saying that there is no need for rationing, that he feels the gasoline lines are going to go away some time this summer, and yet the very real fact is that we are on the brink of a national turmoil that would rival the great depression in terms of its dislocation. There is talk of a national strike and there is clearly an impending war for this distillate fuel.

We had rather frightening testimony yesterday about the problems that are going to be caused to farmers and truckers, and of course to people who heat with oil in the coming year. At the same time we are looking at a dramatic price increase by the OPEC cartel.

A report this morning said that the impact from decontrol will be, I believe, 50 percent higher than earlier estimates. I wonder if the administration is moved at all by that fact. I wonder what the projections were for OPEC oil when in fact the decontrol plan was put into effect. As I recall, the projections were not nearly close for this type of increase in this short a time.

So I hope that out of the hearing today we can come to something resembling a consensus and to at least recognize the problem that exists, the need for dramatic gasoline conservation not only by us but by the administration, the need for a distillate policy that has some teeth in it and has some sense in it and has a system of priorities rather than trying to keep everybody happy with special rule No. 9 and $5 entitlements for those of us in New England.

Again, Mr. Chairman, my subcommittee is pleased to join with yours and the Subcommittee on Energy and Power of which we are members on these hearings. I appreciate it.

Mr. ECKHARDT. Mr. Brown of Ohio is the ranking minority member of the Committee on Energy and Power, and I would recognize him at this time for a statement.

Mr. BROWN. Thank you, Mr. Chairman.

I welcome these hearings also because I think that perhaps once and for all they will establish the absolute failure of controls of both prices and allocation by agencies of the Federal Government.

As everyone should know, but we see little or no publicity on, controls in the energy field as they relate to petroleum have been the rule since 1971 when President Nixon first proposed wage and price controls under the authority granted to him by the Congress. Then we passed, because of the embargo, the Emergency Petroleum Allocation Act in 1973 and under the authority of that act the Federal Energy Office, later the Federal Energy Administration, and now the Department of Energy, has the authority to allocate to the marketplace various supplies of petroleum products.

In 1976 the price controls on distillates were lifted as part of a strategy that was established under the EPCA legislation that the Congress passed in 1975. The fact of the matter is, we have price controls and allocation authority which will extend at least through September 30, 1981, and things like gasoline are still price controlled by the Federal Government, from the crude oil level right through the time that they go out of the pump nozzle into the tank of somebody's automobile.

EPCA, passed in 1975, envisioned a slow lifting of both the price of these products and the lifting of controls in individual refined petroleum items. Some of those items were decontrolled but we never got around to decontrolling the price of gasoline.

The absolute inability of the Federal Government from an agency in Washington to allocate the supplies in our complicated domestic U.S. market of things like gasoline, diesel oil, unleaded fuel, has been demonstrated by the situation that all of us saw as we came to work today in Washington, and that is the long gasoline lines.

In my home State of Ohio, and I hesitate to say this before anyone from the Department of Energy, we don't have gasoline lines and one can buy gasoline at most of the convenient times, although it is now somewhat difficult to find the product. The marketers of the gasoline, that is the independent service station operators, are selling it when it is convenient to them and are closing up on Sundays so they can spend the day with their families too, rather than the hustle they used to be in before.

So I would say that I think these hearings are an excellent idea because perhaps we will establish that the Federal Government cannot either set the price or allocate the distribution of the product for the benefit of Americans; nothing works quite as well as the market system and we just prove it over and over again. As we undertake these hearings, I hope we can get to the point where we can prove it is done much better that way than it can be done by Federal control of this effort.

I do not think we have rationing in places like Japan, which is totally dependent on foreign markets, or Germany; they have managed to deal with it in the market system. Of course those are socialist countries and we have difficulty understanding how they do things there.

Mr. ECKHARDT. Mr. O'Leary, we ordinarily operate by swearing in witnesses before our subcommittee. Do you swear to tell the truth, the whole truth and nothing but the truth, so help you God?

Mr. O'LEARY. I do.

Mr. ECKHARDT. You may proceed.

STATEMENT OF JOHN F. O'LEARY, DEPUTY SECRETARY OF ENERGY, DEPARTMENT OF ENERGY; ACCOMPANIED BY BARTON R. HOUSE, ASSISTANT ADMINISTRATOR FOR FUELS REGULATIONS; MICHELLE CORASH, OFFICE OF GENERAL COUNSEL; AND JIM PETERSON, DIRECTOR, OFFICE OF ENERGY DATA AND INTERPRETATION, ENERGY INFORMATION ADMINISTRATION

Mr. O'LEARY. For the record, I would like to first of all thank you for having with you today the membership of three very important subcommittees all interested in this problem that is before us.

As you can understand, there are enormous drains on the staff that are preparing for these appearances and your contribution to comply in the use of that staff is very, very much appreciated.

I think this is an extremely useful opportunity for us to share what we know about the subject with three interested subcommittees and at the same time to economize in the drain on the already very stretched staff that is necessarily involved at the moment in perhaps too much preparation for congressional appearances. So I want to thank you, Mr. Chairman, for your initiative.

Mr. Chairman, I have a detailed statement that I would be pleased to either read for you or to provide for the record and summarize. It is your choice.

Mr. ECKHARDT. You may proceed in either manner that you prefer.

Mr. O'LEARY. Mr. Chairman, this is important ground and I think that the full statement provides a predicate for our attitude on this matter, and I think I will then take the opportunity to read it in full.

Mr. ECKHARDT. I think that would be desirable.

Mr. O'LEARY. Mr. Chairman and members of the subcommittee, I appreciate this opportunity to discuss with you the middle distillate situation. After reviewing the current supply and price situation, I will discuss briefly the most recent DOE regulatory actions concerning distillates, and offer our current views as to the wisdom of reimposing price and allocation controls.

MIDDLE DISTILLATE INVENTORY PROGRAM

I am able to report to you that our recent actions to improve middle distillate supplies have improved indeed measurable results. Preliminary data show that as of June 22, crude oil imports were 6.9 million barrels per day, which is up 700,000 barrels per day over the previous week. Crude runs were 14.7 million barrels per day, up almost 400,000 barrels per day over the previous week. Most important of all, Mr. Chairman, distillate stocks stood at 135.4 million barrels, up a startling 6.9 million barrels from those reported last week.

I think that demonstrates an increase in stocks of 1 million a day, and it indicates the important contribution to that stock level that can be made if the industry has the crude and has the determination to make it. While this is good news, distillate stocks are still almost 21 million barrels below the level of last year. We therefore must continue rebuilding stocks at the rate achieved this past week. The current problem of attempting to rebuild middle distillate stocks at a rate fast enough to provide adequate supplies for this winter has been compounded by the facts that: Total petroleum supplies so far this year have been inadequate to keep pace with petroleum product demand.

Distillate stocks were drawn down drastically in the latter part of last winter, which means we have had to start rebuilding from a much lower base than usual.

Simultaneously, there have been low stock levels and widespread shortages of motor gasoline—the trade-off product for middle distillates in terms of refiners' choices as to what to produce.

There continues to be considerable uncertainty as to whether political turmoil abroad may commission further disruption in the free world's oil supplies.

In the face of these obstacles, we must increase distillate stocks this summer and fall at a much faster rate than normal. We have targeted 230 to 240 million barrels as an adequate primary stock level for the fall, which compares to about 233 million barrels as the peak level last fall. We should all understand the difficulty of accomplishing this task.

The 230 to 249 million barrel target level was chosen by DOE as a general bench mark for decisions as to what actions to pursue, but has no other magic associated with it. With an ample crude supply and nominal secondary and tertiary distillate stocks, this level could suffice for a somewhat colder than average winter. We have not previously had adequate information on secondary stocks, but we have initiated action to have the Energy Information Administration obtain these data for us.

We have met individually with 32 of the largest U.S. refiners to brief them on DOE's inventory buildup target and to obtain from them their inventory plans for the beginning of October, their expectations regarding crude oil availability and distillate production between June and October 1979, and their ability to increase distillate production at the expense of other products.

On the basis of the information provided by the 32 refiners, we estimate that primary distillate stocks could be about 230 million barrels at the beginning of October, which is at the low end of our target range.

Distillate stocks at the moment are well below the October target and crude runs are short. However, there is reason to believe that the target can be met. Crude oil stocks have reached at least minimally comfortable levels and preliminary data for the last few weeks have also shown considerable improvement in crude oil imports, which could mean that refiners will meet their expected level of crude runs between now and October.

Also, because of tight allocations and reduced consumption by the public, the precipitous decline in motor gasoline stocks which we saw during the months of March and April has been arrested. The public appears to have accustomed itself to a summer and fall of gasoline supplies at levels which will permit refiners to maximize their yields of middle distillates, if crude oil supplies remain at current levels.

Finally, on the basis of the yield flexibility data collected from the 32 refiners, we estimate that the refining industry could increase distillate production by 200,000 to 300,000 barrels per day over current levels.

On balance, we believe significant recovery over the next few months in distillate supplies and attainment of the 230 to 240 million barrel goal can be achieved under current Government policies if the industry does its part. The critical factor is crude oil availability.

If crude oil imports are maintained at 6.2 million barrels per day and refiners adjust their yields slightly in the face of tight gasoline supplies to increase their production of distillate, we will have adequate heating oil supplies for the winter. If crude oil imports fall below 6.2 million barrels per day, or if refiners do not take the necessary actions, we face the very real prospect of severe emergencies among those segments of the public that rely most heavily on heating oil for winter home heat and among those segments of the economy that transport the public and move the goods essential to sustaining the economy.

However, the target itself and our success in achieving it will both require review during the course of the summer and early autumn, as the production and stock trend lines continue to unfold and as further information on secondary stocks is available to us.

At this point I would like to point out a point that I made to other committees, and that is that the 230 to 240 million goal is one that we are absolutely intent upon attaining. We will attain it unless there is a major interruption of the supply. Now we might attain it at the cost of major disruption to other sectors of the petroleum-consuming economy.

I pointed out in this testimony that the tilt fuel is gasoline. But I want to tell you and everyone who is attending this hearing, Mr. Chairman, that the President has made it clear to us that this is the primary goal of our activity during these next few months; that is, the achievement of satisfactory levels of residual fuel oil supply by this fall.

We have the tools, that is to say we can force the refineries to do what is necessary and we have the time to achieve that goal and we have, as far as I am concerned, absolutely no reluctance to use those tools and use this available time to achieve that goal.

Therefore, I can tell you and I can tell particularly Mr. Moffett, who has been very concerned about this, that people, unless there is a major supply interruption, will not go cold this winter because of inadequate crude supply, middle distillate supplies. That is an assurance that is backed by the word of the President and we will during the summer take whatever actions are necessary, Mr. Moffett, whatever actions are necessary to see to it that there is sufficient fuel oil for this winter.

Now there may be runouts and indeed we have had that situation last winter, we were down to the point where one major terminal had 3 hours of supply, and Mr. House, who is on my right, made arrangements to get additional supplies in there. We did not lose a house during that period. We could have, if there was heavy snow or local dislocations, we could of course lose households.

But Mr. Chairman, I want to tell you that we are extremely sensitive to the national cost that would be associated with a generalized shortage of heating oil, and this administration has absolutely no intention of letting that occur. And I want to state again that we have the tools and we have the time to assure you that it will not occur.

Mr. ECKHARDT. Will the gentleman yield a moment there?

Does the gentleman intend to include in that assurance that we will also not run out of diesel fuel? What we are talking about generally is middle distillate.

Mr. O'LEARY. No, I won't make that assurance. It may be that we will have serious dislocations but home heating oil comes first, Mr. Chairman, and then the other elements of supply.

Much of the diesel that is used in this country is used for the movement of goods that are absolutely essential to our well-being, some of it is not, and if it comes down to a choice of that sort we are simply going to have to say that the transport of goods will be the second user and the first user is going to be the supply of heating oil to the homes and residences generally of this Nation.

The result of middle distillate shortages has been a continuing escalation in prices. According to data provided to the Department by the New England Fuel Oil Institute on June 18, residential heating oil prices in New England averaged about 73 cents per gallon on that date. This is up from 52.7 cents per gallon in December 1978, or just about 20 cents per gallon, Mr. Chairman.

In April 1978, the national average retail price of heating oil was 61.1 cents per gallon, which included an estimated 34.6 cents attributable to crude oil costs, 13.5 cents to refiner margins, and 13 cents attributable to reseller/retailer margins. This represents an increase of 5 cents per gallon in crude oil costs over the average for 1978, the 5.9 cent increase in refiner margins, and an 0.8 cents increase in reseller/retailer margins.

Those numbers are graphically demonstrated by the chart that I have just put up. And I think that they show that we are finding increases at all levels, but the disturbing point of that Mr. Chairman, is the increase at the refinery level.

I am not able to tell you today that those increases are not cost justified. We have an inquiry going forward now to determine whether in fact they are cost justified. But I think that this is a time when the refinery community would be well advised to use a great deal of constraint and not to pass into those systems costs that were not absolutely justified on the basis of their increased costs of doing business. You can see that a significant portion of the costs are in fact attributable to raw material increases.

Another surprise is the absence of significant runups at the distribution end of the business as shown by these numbers. Now these numbers are preliminary, but I think that they do give us a statement of what is occurring in this market.

I should point out that comparisons of the most recent month's figures with those for an entire year may not be valid given the ususal seasonal fluctuations in heating oil prices. However, it is obvious that this year is different because of the shortages and rising crude oil costs, since prices have continued to rise throughout the spring, when normally they would be expected to decline. The DOE has not yet collected and compiled statistics for crude costs and margins for the period since April.

To examine the reasonableness of the increase in the refiner margin, the DOE is collecting cost and revenue data for distillates from nine principal distillate refiners for the period January through June 1979. This information will update cost and revenue data already collected from these refiners for the period July 1976 through December 1978. The DOE will also hold a hearing to review the data and to determine whether or not recent price levels are reasonable when compared to costs.

We are continuing to monitor heating oil prices and will again make funds available to the States to assist us in doing so. Eleven States participated in this program last winter. We expect 15 States to participate this winter.

Even if prices are determined to be in line with costs, they will be much higher than last year and will put necessary supplies of heating oil beyond the reach of some low-income families. No reasonable price control system will prevent this from occurring. For this reason, the Department of Energy continues to support, as it has in the past, income assistance programs to help the poor meet rising energy costs.

RECENT GOVERNMENTAL ACTIONS REGARDING DISTILLATE DEMAND

The DOE has undertaken actions directed toward reducing nonresidential demand for middle distillate so that more distillate will be available for residential users.

For example, we have taken a number of steps to transfer demand away from distillates and to natural gas, propane and coal, all of which are in more abundant supply. These actions include removing certain regulatory obstacles to such fuel switching that existed previously in both ERA and FERC regulations. Our estimates indicate that demand for distillate by industrial users has been reduced by about 300,000 barrels a day as a result of these actions.

Other measures to reduce discretionary demand for middle distillates include an order to Federal agencies imposing temperature controls and the soon-to-be implemented mandatory temperature controls for all public and commercial buildings. These controls can be effective in reducing distillate demand even in the summertime because many electric utility peaking plants operate entirely on distillates.

SPECIAL RULE NO. 9

An action taken in May, the adoption of so-called special rule No. 9, had the effect of increasing distillate supplies immediately for some sectors of the economy. That rule required all suppliers of diesel fuel to provide 100 percent of current requirements to (1) agricultural customers, (2) transporters of perishable agricultural commodities, (3) surface public mass transport systems, and (4) oil and gas producers. The principle purpose of this rule was to provide enough diesel fuel for the critical need of planting the Nation's crops.

The combination of the general shortage of diesel fuel and weather conditions—which had condensed the planting season from a typical 8 to 10 weeks to a mere 3 to 4 weeks this year—left many farmers without adequate fuel to meet this critical need.

Special rule No. 9 was successful in accomplishing its objective. We were informed by the Secretary of Agriculture last week that virtually all the Nation's crops were in the ground and that the special rule had been instrumental in commissioning that result.

Special rule No. 9 was not without its drawbacks, however. No allocation scheme—which special rule No. 9 was to a limited extent—can create more total product. Thus, when more was given to agriculture, less was available for other uses that are also important, including the buildup of home heating oil stocks and use as a motor fuel for trucks, railroads and barges.

Thus, as soon as we heard that almost all planting was completed, we rescinded special rule No. 9 except as it applies to mass transportation. This action will make more distillate fuel available for the other important uses I mentioned.

DISTILLATE PRODUCTION POLICY

The Secretary and other departmental officials have been meeting continuously over the past several weeks with the principal refiners to establish for them individual middle distillate inventory targets and urge them to take steps consistent with our number one priority of increasing distillate stocks to acceptable levels. Some refiners have told us that they are already taking the necessary action and others have indicated they soon will do so. Now that crude oil stock and import levels are both approaching normal levels, these efforts at persuasion should soon show results in the production and stock data and, as a matter of fact, already have.

If middle distillate production fails to respond in the very near future to normal market forces and Government exhortation, we will consider some form of mandatory action. This could include refinery yield controls, possibly combined with actions to limit sales of alternative products, such as motor gasoline and jet fuel. It could also include forcing refiners to run their available crude oil supplies or allocating them to other refiners who will.

We will also examine closely whether some current uses of middle distillates could not be replaced by alternate fuels through Government persuasion or allocation orders.

For example, the practice of blending No. 2 fuel oil with high sulfur No. 6 residual fuel oil to create an environmentally acceptable low sulfur fuel is laudable in obtaining environmental goals but may be unwise in view of the threat to home heating oil consumers from a shortage of No. 2 fuel oil supplies. The issue of allowing waiver as to existing State implementation plans under the Clean Air Act, particularly in light of the favorable air quality impacts that are resulting from the program of switching utilities and industrial users to gas, is currently being explored with EPA.

DISTILLATE ENTITLEMENTS

A rulemaking adopted in late May that provides a $5 per barrel entitlement benefit for imports of middle distillates will also be of considerable value if it engenders a response at all like that achieved by a similar action early in 1977. Preliminary data suggest that the action is in fact beginning to have an impact.

During the weeks of June 8, 15, and 22, 1979, middle distillate imports were 176,000, 163,000, and 190,000 barrels per day, respectively, which averaged 70,000 barrels above the level at the beginning of June.

REIMPOSITION OF PRICE AND ALLOCATION CONTROLS

Mr. Chairman, in the remainder of my testimony I will focus on the issue of whether the current situation is sufficiently serious that we should reimpose price and allocation controls on middle distillates. I do not believe we should take such action at this time.

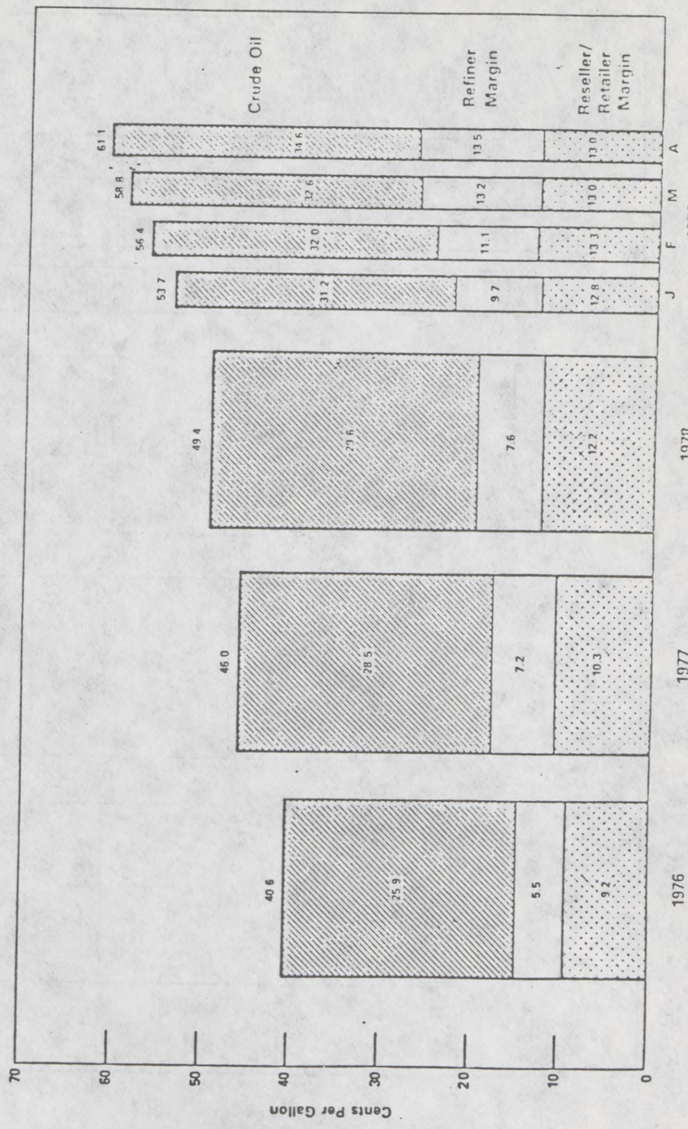
Price and allocation controls can be effective as a last resort during a severe shortage to prevent price gouging or inequitable distribution of supply. We are not afraid to adopt this last resort if and when the circumstances warrant. Price and allocation controls do nothing to increase supplies or reduce demand, however, and can in fact be counterproductive to achieving such objectives. A more prudent course is to monitor continuously the price and supply situation as it unfolds. If we should reach the point where it is apparent that we will not have adequate supplies for the winter, serious consideration of the reimposition of controls would be in order.

In the meantime, both our regulatory and nonregulatory efforts should be focused on increasing supplies of distillates and reducing demand. The best protection against both exorbitant prices and cold homes this winter is not price and allocation controls but an adequate supply of heating oil going into the winter. We are still capable of meeting our distillate targets, and we intend to direct our efforts at this time at that objective.

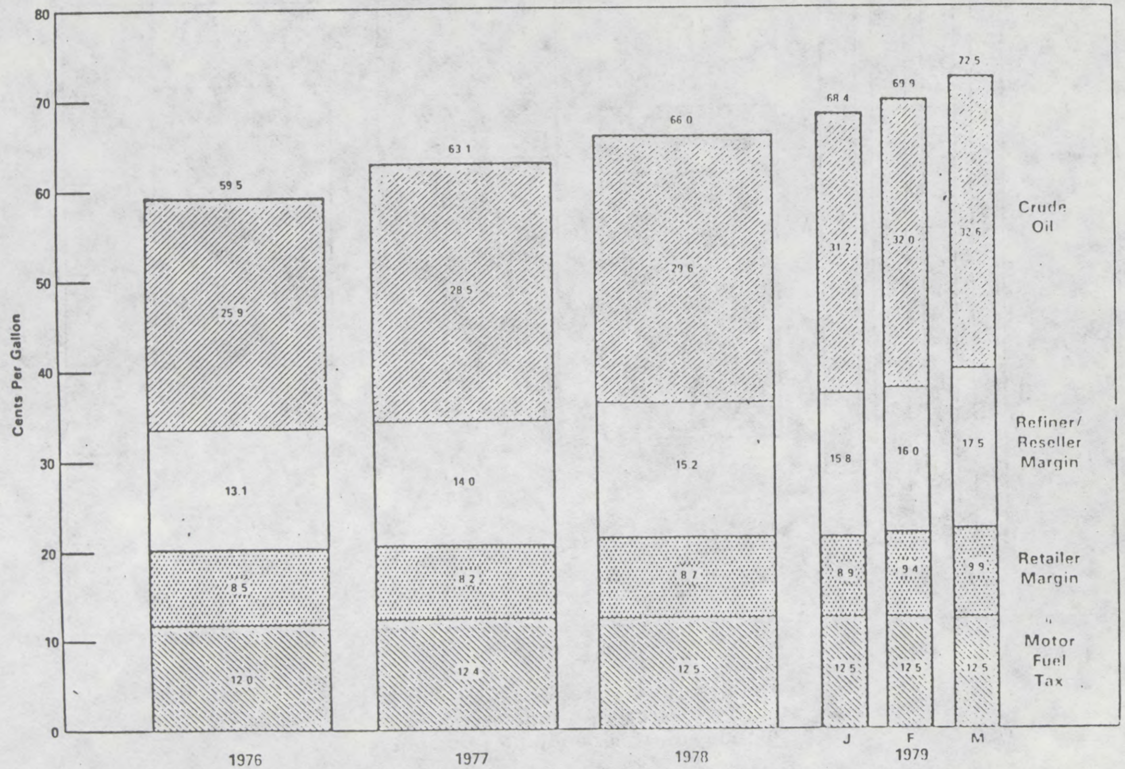
Mr. Chairman, that concludes my prepared statement. If you or the subcommittee members have any questions, my colleagues and I will attempt to answer them.

[Attachments to Mr. O'Leary's statement follow:]

Estimated Components of Residential
Heating Oil Prices
ERA Estimates Based on EIA Data

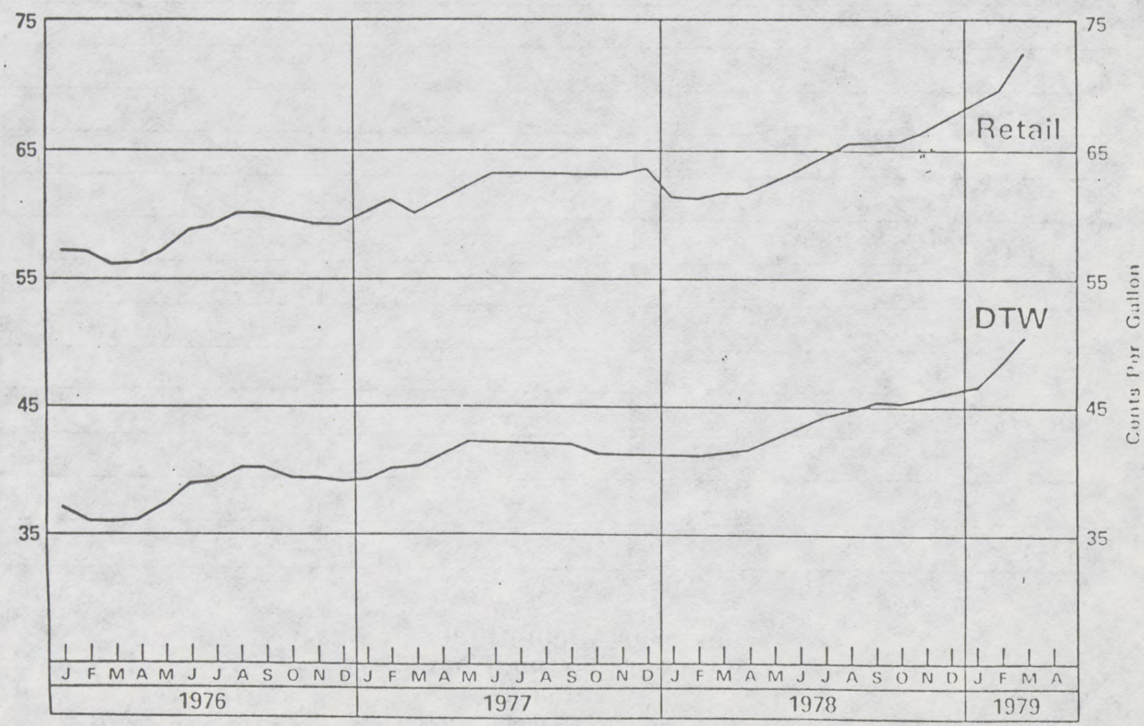


Estimated Components of Regular
Gasoline Full Serve Price



Motor Gasoline

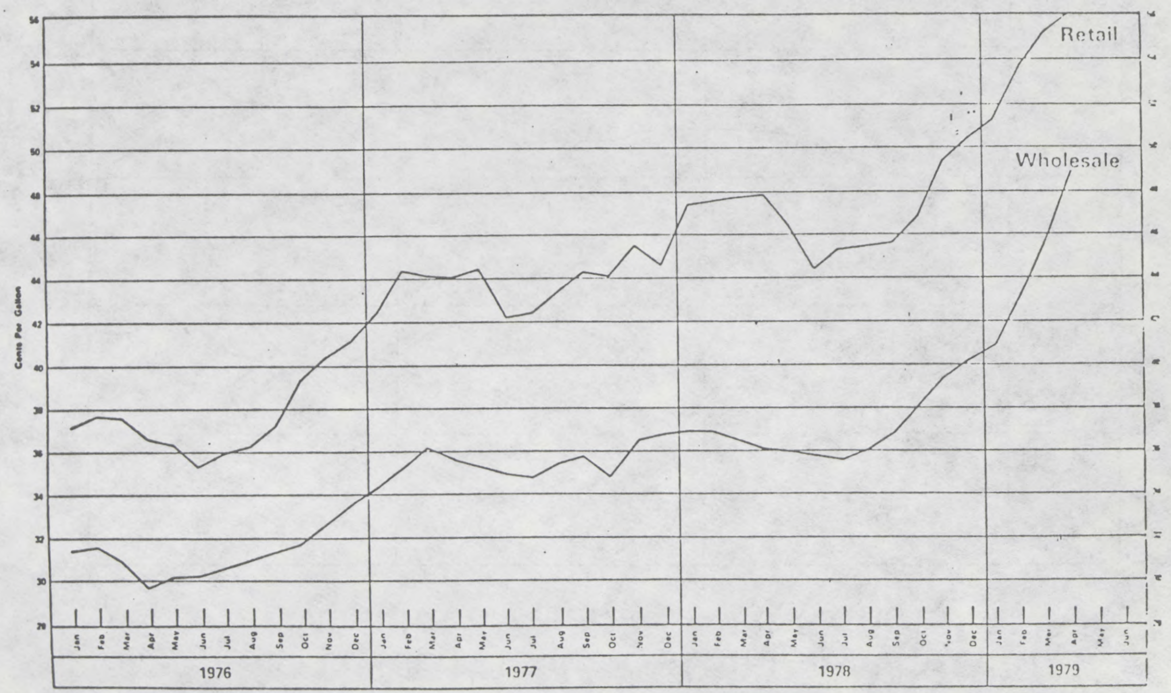
Leaded Regular—Full Serve
Weighted Average—All Firms



No. 2 Home Heating Oil

All Firms

Weighted Average Wholesale and Retail Prices



Mr. ECKHARDT. In recognizing members in the beginning I recognize the ranking minority member of the Energy and Power Committee, but I failed to recognize for a brief opening statement the present senior majority member, Mr. Ottinger.

Mr. Ottinger?

Mr. OTTINGER. Thank you, Mr. Chairman.

Mr. Brown would leave us to the tender mercies of the oil industry to meet our present needs.

Mr. BROWN. Not the industry, the market.

Mr. OTTINGER. The testimony of Mr. O'Leary indicates that that is in effect what is being done by the Energy Department. I think that the real problem which confronts us is an action by the oil industry to fail to refine the crude oil which is available to them.

The statistics which I have available to me show that the demand of the United States is 4-percent lower than for the comparable period of last year, and the demand for gasoline is 8.7-percent lower than during the same period last year.

Production, in the face of the Iranian shortfall, was actually made up by other countries—and in point of fact our oil imports have held up at a considerably higher rate than in 1979.

I do not understand Mr. O'Leary's figures of 6.1 million barrels per day. My figures show that in January we imported 8.5 million, in February 8.2 million barrels per day, in March 8.3 million, and I understand it has gone up in May and June. The utilization of refinery capacity levels, however, have been sharply off.

In February refinery utilization was at 83.8 percent, in March 82.9 percent, in April 84.9 percent, and in May 84.1 percent. This indicates that the refineries have not been processing crude oil which could help to satisfy our gasoline demands, our diesel oil demands, and our home distillate stocks.

In the face of this kind of refinery fall-off, the Secretary of Energy said that he was afraid to exercise the allocation authorities that are available to the departments and Mr. O'Leary indicated that he did not think it was yet appropriate to do so. I fail to see that in the face of increased imports, of domestic production as I understand it, more or less at the same levels that have previously prevailed, why we should not be forcing refinery production at more or less than 90 percent of capacity that was in fact achieved last year.

So I think the problem is not of insufficient control but inadequate control by the Government in the face of a very severe situation.

Mr. ECKHARDT. Mr. O'Leary, to get the questions before us here, the Department has requested refiners to take voluntary action to build distillate primary stock, that is stocks held by refineries, bulk terminals and pipelines for October, so that total distillate stocks reach at least 240 million barrels to insure adequate heating oil supplies for the winter heating season. However, the Department's June 6 memorandum to the White House concluded that, based on current refinery plans, industry stock levels could be at approximately 230 million barrels by October 5, 1979. But to reach the stock level of even 230 million barrels, certain key assumptions were made as to crude run production, imports and demand.

Now I would like to, without objection, introduce into the record a memorandum prepared by our subcommittee staff, somewhat analyzing the scenarios. And I should like also to ask to introduce, without objection, the June 6, 1979, report from DOE to the White House concerning the middle distillate situation.

[The information follows:]

CONGRESS OF THE UNITED STATES
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SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
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MEMORANDUM

DATE: June 28, 1979

TO: Chairman Eckhardt
Subcommittee on Oversight and Investigations

FROM: Subcommittee Staff

SUBJECT: Actual and Projected Middle Distillate Production - June - October

Introduction

On June 6, the Department of Energy sent a memorandum to the White House describing several possible scenarios for the production, consumption, and inventory levels of middle distillates. While the actual stock levels in October will depend on the interplay of several factors, DOE has projected three alternative scenarios. The first is a build-up to a level of 240 million barrels. The second, based on individual meetings between DOE and the 32 largest refiners, is a projected stock level of 230 million barrels, the level DOE believed the refiners would reach without government intervention. The third case, also developed by DOE, results in an inventory level of 230 million barrels while providing distillate supplies this summer at 1978 levels. Each case is described below. It is essential to remember that in each scenario if any of the supply assumptions are not met, or if the demand assumptions are too low, the target is not met.

(MMB/D = Million Barrels per Day)

CASE	CRUDE RUNS	PRODUCTION	DEMAND	IMPORTS
Scenario 1 240 MMB	15.2 MMB/D	3.5 MMB/D	2.9 MMB/D	.150 MMB/D
Scenario 2 230 MMB	14.6	3.1	2.5	.225
Scenario 3 230 MMB	15.0	3.45	2.7	.100
June 1-June 22 Actual	14.4	3.1	2.8	.176

The average supply and demand for the first 22 days of June are clearly far short of the DOE projection necessary to reach an inventory level of 240 or 230 million barrels in early October. According to recent testimony by a ranking DOE official, about 1 million barrels of distillate would have to be added to stocks each day to hit the 230 - 240 target range. Estimated stocks on June 1 were 125.6 million barrels. Estimated stocks on June 22 were 135.4 million barrels, an increase of 9.8 million barrels. Divided by 22 days, this is an average increase of only 445,454 barrels a day.

MIDDLE DISTILLATE SITUATION

JUNE 6, 1979

Background

More than 16 million homes in the United States use middle distillate as a primary energy source for heating. Middle distillates are also used as diesel fuel for agricultural production, trucks, barges, buses, railroads and utilities.

The purpose of this document is:

- To present an overview of the current and projected middle distillate supply situation, and;
- To present strategy options to achieve our primary goal of building middle distillate stocks, while taking all practicable steps to ensure adequate supplies of gasoline and other petroleum products.

Middle distillate inventories had dropped to unacceptably low levels by the end of this past winter. This occurred for a number of reasons:

- Gasoline demand remained high and stocks dropped to extremely low levels in the latter part of 1978. In early 1979, refiners rebuilt gasoline stocks while demand for gasoline remained high. Refiners therefore produced proportionately more gasoline and less distillate than they would have, causing heating oil inventories to be drawn down.
- In early 1979, refiners reduced crude oil runs as a result of the Iranian situation and the uncertainty surrounding foreign crude oil availability.
- The weather was extraordinarily cold in the first quarter of 1979 causing a sharp increase in demand for middle distillates and short run distribution problems.

As a result of these factors, the Administration recognized that these low inventories could lead to major shortages of home heating oil next winter if existing supply/demand trends continued. The Administration also acknowledged that the supply situation for middle distillate could create serious hardships for farmers engaged in agricultural production. Moreover, due to sustained unfavorable weather conditions in the Midwest, the planting season, which normally runs from late March through late May and in some areas continues into June, was delayed by several weeks. Consequently, Midwestern Spring planting operations which normally take place over a two-month period needed to be completed in the past few weeks and, therefore, the demand for diesel fuel for agricultural purposes during this period was compressed into an abnormally short time frame.

This situation resulted in the following major initiatives:

- DOE established a target of 240 million barrels of national distillate stocks by October, 1979 and urged refiners to voluntarily meet their proportionate share of stock buildup while meeting current levels of demand.

- DOE, on May 10th, adopted Special Rule No. 9 permitting consumers engaged in agricultural production including commercial fishing to obtain their full middle distillate requirements on a priority basis, through July 31, 1979. The Special Rule was extended to cover surface mass transportation, trucking of perishable agricultural commodities and exploration and production of oil and gas.

Both of these initiatives are discussed in the following sections.

The 240 Million Barrel Build Up Strategy

DOE projected that 240 million barrels of middle distillate inventory would provide a reasonable margin of assurance to meet demand for the upcomimg Winter. In this connection, the forecasted demand for distillate was six to seven percent above corresponding levels in the previous years. The The 240 million barrel target was based on assumptions of:

- 15.2 million barrels of crude runs per day;

- 23 percent average refinery yield for distillates resulting in 3.5 million barrels a day production during 1979/1980 Winter;

- distillate imports equal to those of 1978; and

- demand averaging 2.9 million barrels per day.

- winter weather conditions that are 5% colder than normal.

At the end of the heating season (April 1st) distillate inventories stood at 113 millon barrels, 18 percent below stock levels at the same point the previous year. Therefore, during May 1979, meetings were held between ERA and 32 of the largest U.S. refiners. These refiners account for more than 80 percent of distillate production. DOE had audit teams at all 32 refiners for data verification.

At the meetings, DOE requested information regarding their inventory and production plans. DOE discussed, with each refiner, a theoretical plan by which the industry as a whole and each refiner could reach the aggregate goal of 240 million million barrels. In the DOE theoretical plan, each refiner was asked to compare DOE's theoretical plan with its own production and inventory plans. The inventory for each refiner was placed at nine percent above the refiners October 1, 1978 inventory level. Nine percent is the amount by which the entire industry would have to increase inventory levels above last year's October 1 level in order to reach the 240 million barrel target.

In the DOE plan, the voluntary production for each refiner was set at eleven percent above the refiner's average production of distillate during 1978. Eleven percent is the amount that the industry would have to increase production in order to reach three and one-half million barrels per day.

The refiners were also asked questions concerning supply arrangements with bulk terminal operators and their summer fill plans. The refiners were asked to respond to these questions and to provide the DOE with their inventory and production plans within a week of the meeting and have done so.

The Department estimated that, based on current industry plans without government intervention, industry stock levels could be at approximately 230 million barrels by October 5, 1979. This estimate was based on information provided to ERA by the 32 refiners regarding their production and inventory plans, and adjusted to account for the entire industry.

Five key assumptions underlie the 230 million barrel projection:

- crude runs at 14.6 million barrels per day;
- distillate production at 3.1 million barrels per day;
- 21.5% average refinery yield for distillates;
- imports at a 150 percent of 1978 levels; and
- demand averaging 2.5 million barrels per day, as compared to 2.7 million barrels per day for the same period of 1978.

To adjust the data received from the 32 refiners to cover the entire domestic refining industry, it was assumed that the remainder of the industry would produce the same quantity of distillate as they did in the comparable period of 1978. It was also assumed that they would hold the same volume of stocks on October 1, 1979 as they did on October 1, 1978. Additionally, it was assumed that they would operate at the same 87 percent rate of utilization as the 32 refiners in the survey. These assumptions may not be valid if small refiners experience difficulties not experienced by the 32 surveyed refiners.

CURRENT MIDDLE DISTILLATE SITUATION

Inventories

As of May 25, 1979, the nation's inventories of middle distillates, including both No. 2 diesel fuel and No. 2 home heating oil stood at 122 million barrels, 23 million barrels lower than they were at the end of May 1978. For the 4 weeks ending May 25, 1978 middle distillate production averaged 3.0 million barrels per day compared with 3.2 for May 1978. Imports averaged 115 thousand barrels per day, as compared with 119 thousand barrels per day for May 1978. Demand for middle distillates averaged 2.9 million barrels per day as compared with 3.0 million barrels last year. Comparing the most current monthly averages with those of the same period last year, stocks are down 16 percent, production is down 6 percent, imports are down 3 percent.

<u>Status of Inventory Build Up</u>

In order to achieve a projected 230 million barrel stock level, some refiners indicated that they would take steps to build inventories by allocating product. Suppliers are also changing traditional supply arrangements with wholesalers and bulk terminal operators, not offering summer fill programs, and withdrawing from some marketing areas to allow the buildup of distillate inventories.

It should be noted that achieving a projected 230 million barrel stock level requires <u>all</u> assumptions to be met including:

- Crude runs at 14.6 million barrels per day. However, crude runs are currently 14.2 milion barrels per day. Since January, monthly average curde runs have remained well below 14.6 million barrels per day. The four month average between June and September last year was 15.0.

- Distillate production at 3.1 million barrels per day. Currently, distillate production is at 3.0 million barrels per day. The four month average between June and September last year was 3.2 million barrels per day.

- Imports at a 150 percent of 1978 levels from June 1, 1979 through September 30, 1979. Imports for the four week period ending May 25, 1979, are 97 percent of 1978 levels for May 1978.

- Demand for middle distillates averages 2.5 million barrels per day through September. This is 94 percent of 1978 levels which were 2.7 million barrels per day. For the four week period ending May 25, 1979 demand averaged 2.9, 4 percent below May 1978.

- A supply demand balance requiring an inventory buildup of 826 thousand barrels per day between the end of May and the first part of October, a 33 percent increase in the per day inventory buildup over last year.

Clearly, if current market trends continue, an inventory buildup target of 230 million barrels will not be met, unless steps are taken to constrain summer consumption to an average of 2.5 milion barrels per day.

For illustrative purposes, we used the average numbers for the 4 week period preceeding May 25, 1979. We realize that these numbers may not be consistent with actual market developments during the summer. However, in the event that these levels remain unchanged throughout the summer, stocks will be about 194 million barrels by October, which is 86.5 percent of last year's level and 83 percent of the 230 million barrel projection. Table One, Comparative Stock Projections, illustrates the disparity between the 230 target and May data trends.

The Department of Energy has developed a potential supply case that is significantly more optimistic regarding the level of crude runs than the assumptions used by the industry. Under this case, distillate stocks could be built to 230 million barrels by October while continuing to provide distillate supplies this summer at the 1978 levels. This potential case is based on the following assumptions:

- Net imports of crude oil would be 6 million barrels per day in June (about the same level as in the last two weeks in May) and would increase to 6.1 in July and to 6.2 in August and September.

- Refiners would draw down their current crude oil stocks by 30 million barrels, which DOE believes is feasible.

- Crude runs to stills would then average 15 million barrels per day. Refiner yields of distillate would average 23%.

- Distillate imports would average 100,000 barrels per day.

The distillate stocks could be increased to 240 million barrels by reducing consumption this summer by 80,000 barrels per day or about 3%.

Table Two, Potential Supply Scenarios, depicts anticipated October stock levels under vaious assumptions compared with 1978 levels.

TABLE ONE

COMPARATIVE STOCK PROJECTIONS

Refiner Survey vs. Current Trends

DOE Estimate for 230 Stock Buildup Based on Survey of 32 Refiners

Yield	Runs	Production	Demand	Capacity Utilization	Distillate Imports, % of Last Yr.	Anticipated Primary Stocks
21.5%	14,624	3,150	2,536	87%	150%	231 MMB

May 1979 Levels Assuming No Change Through September

Yield	Runs	Production	Demand	Capacity Utilization	Distillate Imports, % of Last Yr.	Anticipated Primary Stocks
22%	14,249	3,125	2,695	84.8%	77%	194 MMB

TABLE TWO

POTENTIAL SUPPLY SCENARIOS
(June through September)
(Thousands of Barrels per day)

	Crude Runs	Production	Imports	Per Day Inventory Buildup	Demand	Antici-pated October Stock Level
1978 Level	14,962	3,167	150	621	2,695	220,800
DOE Response Plan	15,196	3,495	141	724	2,892	240,000
DOE Estimate Based On Refiner Plans	14,624	3,150	212	826	2,536	231,600
May Level*	14,249	3,125	115	545	2,695	194,000
DOE Estimated Potential Level	15,000	3,450	100	855	2,695	229,100

This is a straight line projection through September 30th of the activities in the four week period ending May 25, 1979.

SPECIAL RULE NO. 9 STRATEGY

DIESEL FUEL USES

Diesel fuel is the principal fuel used for farm production and transport of farm products. Diesel fuel requirements for farming in 1979 are estimated at 2,734 million gallons.

Diesel fuel needs for farm production range from a low of 3 percent of total demand in December and January to a peak of 15 percent in May. Another peak occurs in September when Fall harvest is in full swing and diesel needs that month exceed 10 percent.

Diesel requirements for Spring planting, Summer irrigation and Fall harvest conflict with the building of middle distillate reserves for the Winter heating season.

SPECIAL RULE NO: 9

In response to the tight supply situation for middle distillates and the difficulties experienced by several essential sectors of the economy in receiving available supplies, DOE adopted Special Rule No. 9, on May 10, 1979. Special Rule No. 9 temporarily provides priority status to agricultural users, mass transit, and oil and gas production. On May 25, 1979, priority status under Special Rule No. 9 was extended to trucking of perishable agricultural production. Consumers engaged in these activities are permitted to receive 100% of their current requirements for middle distillate through July 31, 1979. For agricultural production, the success of Rule No. 9 could be judged on the basis of the percentage of planting completed in the same period in 1978.

PERCENTAGE COMPLETED

	May 27, 1978	May 27, 1979
Soybeans	35%	47%
Corn	75%	89%
Cotton	77%	76%
Rice	93%	90%
Spring Wheat	84%	71%

Considering the unfavorable weather conditions in the early planting season, the current amount of completed planting appears reasonable. DOE believes that the requirements for the agricultural sector largely have been met by Special Rule No. 9. Given this fact the continued implementation of the Rule poses several potential problems.

Special Rule No. 9 is an emergency measure. It allocates distillate away from other uses and into the areas specified by the Rule. There is evidence that other distillate users are suffering from the distortions created by this allocation. Other users of middle distillate, the trucking industry, freight rail transport, utilities, and home heating oil users are being impacted by the Rule. Further, the continuation of Special Rule No. 9 is causing a major drain on available middle distillate supply. Moreover, with the Rule in place, the rebuilding of heating oil stocks cannot proceed on schedule.

Therefore, we recommend that Special Rule No. 9, for agricultural uses, be lifted by June 30th in order to allow normal supply priorities in distillate to re-emerge.

POLICY OPTIONS

We cannot predict what crude imports will be for the remainder of the Summer. It is possible, therefore, that crude runs could be as low as projected by the refiners (14.6 million barrels) or even as low as current levels. It is also not clear whether refiners will switch their yields sufficiently to maximize distillate stock buildup.

Refiners may be reluctant to voluntarily switch from maximizing gasoline for immediate sale to maximizing distillate for inventory buildup without receiving mandatory yield orders from DOE. If refiners follow historical patterns and maximize gasoline production during the next three or four months, heating oil stocks will not be built up to the target levels, except with a large shortage in distillate supplies for use this Summer.

In addition, abnormally high diesel demand this Summer for agriculture and other Special Rule No. 9 priorities may also adversely affect refiners and wholesalers' ability to build distillate stocks for heating purposes next winter. For this reason all distillate priority assignments should be carefully monitored to insure that they do not unduly detract from the industry's ability to meet regional distillate demands for space heating purposes this Winter.

The DOE proposes to monitor crude oil runs, utilization rates, and imports as well as middle distillate yields, production and import levels through June 30, 1979. This allows some additional time to determine if crude runs are increasing as refiners have indicated they would and to assess the impact of the entitlement program on distillate imports.

If the industry does not appear to be performing satisfactorily with respect to building middle distillate stocks by June 30, 1979, the following alternate courses of action must be considered for implementation:

- Allocate Distillate to Utilities

  Utilities use distillate oil in combustion turbines during peak periods. Summer air-conditioning load is a major contributor. Regionally imposed allocation fractions based on a historic base year (1977 or 1978) could be accommodated by utilities through 1) switching to gas where feasible, 2) encouraging voluntary conservation at peak hours, 3) purchased power where feasible, and 4) temporary load shedding when other methods are insufficient. The amount of curtailment needed is inversely related to the success achieved in the other three areas.

  Regional fractions that keep likely curtailment to a given level could be developed, based on anticipated reserve margins, fuel-switching capability, current fuel stocks, and other factors. Nuclear unit shutdowns must also be considered.

- Relax Clean Air Standards

  In order to meet state and local air emission limits on sulfur dioxide (often as low as 0.25% sulfur fuel oil), some utilities purchase a blend of distillate oil (No. 2) and residual oil (No. 6). By temporarily relaxing the sulfur restrictions, residual fuel could be burned directly without distillate, thus freeing up distillate. These restrictions are generally imposed at the local or state level. We could, therefore, urge state and local authorities to request the President's approval to temporarily relax sulfur emission restrictions on utilities to allow burning of higher sulfur residual oil (or coal) in base loaded units. The Environmental Protection Agency would need to be able to act quickly to approve such requests.

- Discourage hoarding by large users of distillate.

  Unnecessary stock building, particularly by large users of product, such as utilities, could be creating a large part of the current distillate shortage. It could also be contributing to price increases, as large users such as utilities have the purchasing power to pay high prices for insured supply. Normal supply practices by suppliers could be mandated, unless good cause could be shown by the supplier for reduced levels. Anti-hoarding provision could carry requirements to divest of unnecessary stock, and could help eliminate false supply constriction and demand bumps.

- Issue Refinery Yield Orders

  - Under the authority of Section 14 of the EPAA as amended, DOE may "require adjustments in the operations of any refinery in the United States with respect to proportions of residual fuel or any refined product." As a refinery yield order issued to increase distillate production will have an impact on other petroleum product supply, careful consideration must be given to the overall impact of such an order.

The refining industry is capable of shifting yields in response to changes in market conditions. There is a normal shift from maximum gasoline production during the summer to maximum distillate during the winter to meet seasonal demand patterns. Slight shifts from gasoline to distillate (approximately 3-5%) can be made with little impact on overall refinery operations or other non-gasoline products. Any such shift, however, will further aggravate the gasoline supply situation. As an example, a 1% gasoline to distillate shift at the 14.6 million barrels per day crude run level would make available 146 thousand barrels per day distillate for inventory buildup. The resulting gasoline production loss (roughly barrel for barrel or146 thousand barrels per day) would result in almost 2% reduction in overall gasoline supply ratio.

Yield shifts beyond the 3-5% range would require major refinery operation changes and would have significant impacts on other refined products such as jet fuel and petrochemicals. In some cases, refiners may not be able to maintain product quality (e.g. gasoline octane) with drastic yield shifts.

Moreover, refinery yield orders in themselves do not guarantee increased production of distillates. The Refinery Yield Program can only influence the proportionate availability of different products. If economics are not satisfactory, refiners can choose to comply with a yield order at a reduced crude oil run level, rather than at an increased distillate production level. Therefore, the decision to issue refinery yield orders should be made only after a careful assessment of all relevant facts has been made and a conclusion has been reached that no other alternative action will accomplish the desired result.

Other options could include:

— Expediting the switching of utilities and major industrial users of middle distillates to alternative fuels;

-- Expediting the implementation of mandatory conservation plan No. 2, Building Temperature Thermostat Restrictions, and

-- Terminating Special Rule No. 9 for agricultural purposes on June 30, 1979.

In summary, we believe that if current distillate supply and demand trends continue through June 30, 1979, the Administration should begin examining in greater detail one or more of the options outlined above. Decisions with respect to mandatory measures will have to be made in July in order to allow time to rebuild stocks sufficient for the next heating season.

Mr. ECKHARDT. I would like to ask a few questions concerning these matters.

First, it was assumed that crude runs would be at 14.6 million barrels per day. However, crude runs during the first 3 weeks of June averaged only 14.4 million.

I recognize, Mr. O'Leary, that in your testimony here you are relying on the last week which does show 14.7, but that is only for a week and that would be a rather weak reed to lean on, it would seem to me, as a statistical analysis.

We hope you are right and we noticed that you have become much more optimistic in the last 4 days when you say "I am able to report to you that our recent actions to improve middle distillate supplies has produced some measurable result." And I think 4 days ago you said, "Unfortunately, I am unable to report to you that our recent action to improve middle distillate supplies have yet produced measurable results." I suppose that last week is what made the difference.

Mr. O'LEARY. I would like to comment on that last point, Mr. Chairman.

What we have done is attempt to tell you, the Congress, the American people, that if the history of this business as it develops, at any given date I give you in my appearances before you and your colleagues the best information that I have available to me.

You are referring to testimony that I offered earlier this week. At that point we were simply seeing no turnup in stocks of middle distillate. At the moment now we do.

Mr. ECKHARDT. I thought I had recognized that, that you have additional information.

Mr. O'LEARY. Precisely, yes. Tomorrow I might come back and say that information was in error and there was a turndown. I really think that we ought to understand that in trying to convey information we are going to have some internal contradictions. They should not, however, lead to a demise of the little bit of credibility that we have left to us.

Mr. Eckhardt. Mr. O'Leary, I am not trying to show—to discredit you in changing a position when you had additional facts upon which to base your later statement; I am merely pointing out that if you use the 3-week average we are in a situation in which we are 200,000 barrels less than the assumption that was contained in the memorandum. I hope that the last week is more important and more reflective of the actual situation than the 3 weeks' average, but at least I think there must be a caveat concerning whether or not that factor upon which your assumption was based holds forth.

Mr. O'Leary. Yes. I also must tell you that we have a good deal of information with regard to the future in this particular area. We are able to predict with remarkable accuracy the availability of domestic crude; it varies only within very narrow limits. We have what we refer to internally as a crude watch program that tells us the acquisitions abroad of the large purchasers of crude, and with adjustment to those figures, we can tell with fair degree of certainty when that crude will arrive in the United States and, consequently, what our imports would be as much as 5 weeks in advance.

So consequently, when we are making estimates and projections based upon let's say 14.7, it is not just a vague hope, it is based at least to a degree upon analytically sound data series that have been developed for precisely this purpose so that we could predict the arrivals and consequently the capacity of the U.S. refining industry to run.

Mr. Eckhardt. Let me go to the second assumption.

Distillate imports were assumed at 150 percent of 1978 levels, which would require approximately 225,000 barrels a day. While June imports are up compared to May, the average was 176,000 barrels per day or 40,000 or 50,000 less than necessary to meet your assumptions.

Mr. O'Leary. I think the trend is very important there, Mr. Chairman. You will find that it went from about 100,000 barrels on up to the 150,000 to 170,000 barrel range; this last week was 190,000 barrels.

We are very encouraged by that trend. It was the target of our $5 middle-distillate action to reverse that outflow from the Caribbean that was going into other markets and return it to the United States, and I think that is succeeding.

I think we can be relatively optimistic with regard to holding that number within the 200,000-barrels-per-day range and that is really about what that memorandum meant. You understand that when you get to the point where you translate the figures into 212,000 barrels per day or 14.7 million barrels per week you are getting to a degree of fineness that exceeds the capacity of the data to really portray reality.

Mr. Eckhardt. Now let's take the third and most important assumption underlying the 230 MMB inventory level projected by the 32 refiners, that is scenario No. 2 in the chart before you. Demand must average 2.5 million barrels a day as compared to 2.7 million barrels per day for the same period in 1978.

However, demand for the first 3 weeks of June was at 2.8 million barrels, clearly above an acceptable level, if these assumptions are to be met.

Mr. O'Leary. Yes. I believe that was directly attributable to special rule 9, where we had not only the compaction in the agricultural planning season that I discussed earlier but I am fairly content myself that we had significant leakage associated with that rule. I think we will find that will be sharply down now, fundamentally as a result of the fuel switching program that we put into effect through Mr. House's office in February and March and the optimization on coal and nuclear generation to replace oil generation.

We are making a savings of middle distillate of 300,000 to 400,000 barrels per day. That in normal times—I am corrected, 200,000 barrels a day. That in normal times should be enough to bring us into this kind of a range of demand that we are discussing here.

Mr. Eckhardt. Well, I hope you are right. But I have pointed out here that three of the assumptions upon which your scenario was based have not been met by recent figures, unless of course the last week only is more meaningful than the 3 previous weeks with respect to crude runs.

Mr. O'Leary. Mr. Chairman, that is precisely the point of the statement that I made, the interpolation that I made in my initial statement, that if it becomes necessary to intervene more, with more in the way of mandating into the market than has been the case thus far, we have both the time and the capacity to do so.

What we are doing is, we are trying to follow the pattern, regulatory pattern that we established, and I think with enormously good results in 1977 during the critical shortage of natural gas and again during the 111-day coal strike of 1978. And that is to use to a minimum our raw mandating powers but to use the voluntary mechanisms that are available to us, persuasion, assistance, sometimes verging on coercion, to achieve a national objective.

I can only point to the absolute salient success of those two prior experiences as the predicate for my faith that we will be able to do this one, one way or the other. Our posture is simply this: We do not want to use mandating because it has, as we find in every instance in which it has been applied, effects that are aberrant, effects that you cannot predict, at least we are not smart enough to predict at the time we put in the mandating, and effects that we know will be disruptive.

For example, we had some terrible side effects from special rule 9 that made us flee from it as fast as we could. We encouraged leakage. Let me just explain that, Mr. Chairman.

Mr. Eckhardt. I do not want to argue with you about the rule now, but——

Mr. O'Leary. I think your preoccupation should really be, do we have the time, using all of our instruments, to achieve our objective? My answer to you on that is yes.

Mr. Eckhardt. Well, I am glad—I hope that is right and I hope your faith holds up, but I would say the bottom line is that during the past 3 weeks of June only 445,000 barrels per day have been added to the inventory, instead of 1 million barrels per day.

Mr. O'Leary. During the last week, my bottom line is 1 million barrels per day went into stock.

Mr. Eckhardt. That is in the last week?

Mr. O'LEARY. That is precisely right.

Mr. ECKHARDT. Secretary Schlesinger said on June 21 in his press conference, 1 week's results cannot be taken as determinative; one must attach some degree of variance as to the particular number.

I hope you are right, but I want to know when would you feel you had reached the point of no return if it appears that the addition to stocks is not sufficient?

Mr. O'LEARY. Well, there is no particular point in time, Mr. Chairman, where you would reach that determination, or that I can predict now. Let me tell you why not.

It would depend upon the outcome of our inventory of secondary stocks. There was, as you know, an absolutely abnormal disappearance from primary stocks of middle distillate in the first quarter of this inquiry. It may be when we finish this we will find ourselves to be in a much more comfortable position with regard to middle distillate inventories than we now know to be the case. That is the first uncertainty. We will have that within the next 2 or 3 weeks.

The second point, what can we say with regard to a sustained level of imports. If we slide back to the 6.2 level from last week's 6.7, that is one case. If we do advance, and there are certain indicators in the system that we may have an increase in crude imports over the next few weeks, then that provides quite a different case. So there are a sufficient number of variables in the system to make it impossible for me to provide you a formal answer to your question.

This will have to be the applied judgment, watching the situation that develops, measuring all those variables that come along and at some point we may say to ourselves, "Ah, we made it." Or we may also say, "Ah, we can't make it." We will now go in and force the system to achieve our objective.

Mr. ECKHARDT. I just hope we do not make that decision too late. As I understand, the Department did not anticipate the shortage of domestic crude production this year nor even notice it until recently.

Mr. O'LEARY. I do not know what you are referring to.

Mr. ECKHARDT. Domestic production.

Mr. O'LEARY. Domestic production has been precisely in accordance with history over the course of this year. You, I believe, are looking at a confusion between two different data series that give you a totally misleading result, but my information from the Energy Information Administration is that when those results are properly interpreted, there has been nothing unusual occurring in the first half of this year, first part of this year.

Mr. GORE. Will the gentleman yield?

Mr. ECKHARDT. Yes.

Mr. GORE. Now I think that this confusion is the result of different periods.

Mr. O'LEARY. Surely.

Mr. GORE. You are coming up with averages on domestic production from February through May. What we are asking you about is the abnormal decline beginning in November of last year and bottoming out in February and not coming back up until the end of March.

We have the average decline over the last 4 years, 1974 through 1978. You have the normal decline in the winter, but what happened this year was this abnormally large decline. I do not think it is a confusion of data streams.

Mr. O'Leary. Mr Gore, please explain the vertical scale of that chart. That enormously exaggerates what has been happening. You are dealing really with a swing of around 300,000 barrels a day on a base of over 7 million barrels a day, and I really think that that is really a very small tweak in the one.

Mr. Gore. If the——

Mr. Eckhardt. Will you yield back to me?

Mr. Gore. If I can make one final point.

It is not a little blip. Our figures show it to be 36 million barrels short of the same period last year and, the year before that, during the time of crisis the domestic producers apparently depressed production according to these figures.

I thank the chairman for yielding.

Mr. O'Leary. I would like to point out, Mr. Chairman, that we are suffering in this country a decline rate that is about 3.3 percent a year and it goes on year-in and year-out and the Energy Information Administration, which has been in touch with the point that Representative Gore is making, tells me that there has been no abnormal dip in that production during the last 6 months or thereabouts.

Mr. Eckhardt. Mr. O'Leary——

Mr. Brown. Production of what, may I ask that? I have lost that point somewhere.

Mr. O'Leary. Production of crude, Representative Brown.

Mr. Brown. Thank you.

Mr. Eckhardt. May I point out to you with respect to the decline of production, actually production over the year 1978 ran higher than production had run over the year 1977, over the year 1976, and over the year 1975.

But production in 1979 is down. As a matter of fact, you state in your testimony of June 27, before the Joint Economic Committee, and I quote: "Reported domestic production in recent weeks has been nearly 200,000 barrels per day below the 8.6 million barrels per day projections."

Actually, according to DOE data the production in 1979 has been 8, in January it was 8.346 million barrels; in Feburary 8.286 million barrels; in March, 8.369 million barrels, and then up in April 8.618 million barrels, and then down again in May, 8.553 million barrels.

Now, certainly there has been a blip, a downward movement in production during that period of time, starting in about November of last year and just now recovering. Now I do not recall that DOE predicted nor has explained the reason for this blip at this time.

Mr. O'Leary. Mr. Chairman, first of all, with regard to the increase in production in 1978 over 1977, you will recall that the great event in oil circles in the year 1977 was the advent finally of the Alaska pipeline and that kicked up availabilities by the end of the year by about 1.2 million barrels a day. That was the enormous change there.

Underneath that there has been a sustained downturn that was veiled by the coming on of Alaskan production, a sustained downturn in production of the lower 48. I have among this 9 pounds——

Mr. ECKHARDT. No question about that.

Mr. O'LEARY. Yes, it is. I really think what we are seeing here on these recent data is a comparison of three data series, as explained to me by the Oil Import Administration.

First of all, we obtain data from the old Bureau of Mines series, a series close to my heart because I used to direct that bureau. Those data are derived from States and they are derived on the basis of State taxation and tend to be fairly good because the States, your own included, derive a lot of the revenues and like to be very precise in getting those numbers. There is a lag in those of some 5 or 6 months, as I understand it.

I am going to make an incomplete, necessarily incomplete explanation of this because the people with full explanation unfortunately are not with me this morning.

Second, we derive data from an old FEA form that picks up, transfers within the system. This is a series that is known to understate production by about 200,000 barrels a day. So I think when we join those two together, we get a dip.

There is a third series that goes into much more recent experience and that adds to an anomaly. The fact is we do not have good data that are reliable for the purpose to which you are putting them now.

Mr. ECKHARDT. I am only using your data.

Mr. O'LEARY. Yes, I know, and I want to put the caveats on those data. They are as good as we have but they are not reliable for fine points until they are about 6 months old.

Mr. BROWN. Mr. Chairman, perhaps it would be helpful to ask how many individual sources are there of those.

Mr. O'LEARY. The individual sources of those data are probably somewhere in the range of 14,000 or 15,000.

Mr. BROWN. I am always happy to have the opportunity to ask questions. But I think there were other people here first, if you are going in the order of arrival of the members.

Mr. O'LEARY. I have a comparison of three series.

Mr. BROWN. But I don't want to lose the point about the number of sources, 15,000 different sources.

Mr. O'LEARY. There are 15,000 different sources and three series, API, Bureau of Mines, and the old FEA reporting system. Mr. Chairman, I have a comparison of those three series that takes us up through May 1979, and I would like to include that at this point in the record, if that is possible.

Mr. ECKHARDT. Without objection, it will be included at this point in the record.

[The information follows:]

Draft
6/29/79

3rd Published

2nd Published

COMPARISON OF CRUDE OIL PRODUCTION STATISTICS

(Thousands of Barrels Per Day)

1st Published

Month & Year	Monthly Petroleum Statistics Report	Difference	Monthly Petroleum Statement	Difference	API Monthly Statistical Report
1978					
January	8,341	6	8,347	279	8,626
February	8,236	137	8,373	8	8,381
March	8,678	129	8,807	-90	8,717
April	8,696	12	8,708	304	9,012
May	8,586	215	8,801	38	8,839
June	8,608	214	8,822	97	8,919
July	8,585	162	8,747	157	8,904
August	8,595	193	8,788	142	8,930
September	8,578	209	8,787	69	8,856
October	8,636	195	8,831	-24	8,807
November	8,578	151	8,729	74	8,803
December	8,593	58	8,651	190	8,841
1979					
January	8,346	111	8,457	242	8,699
February	8,286	212	8,498	93	8,591
March	8,369	215	8,584	107	8,691
April	8,380		NA		8,618
May	NA		NA		8,801

NA Not Available.

- EIA Preliminary Series
- Available 45 days after close of month
- Based on FEA Form P-124 Crude Oil First Purchasers System
- Doesn't include Direct Use, USGS Royalty Oils, And other non-sale uses amounting to About 150-200,000 bbls/day

- EIA Final Series
- Available 90-100 days After close of Month
- Based on State Production And Revenue Data

- API Series
- Used in Weekly Status Report
- Consistently higher than "Final" Numbers

Mr. ECKHARDT. Mr. Moffett?

Mr. MOFFETT. Thank you, Mr. Chairman.

Mr. O'Leary, do you agree that the gas lines will be gone this summer?

Mr. O'LEARY. Mr. Moffett, I am not at all sanguine that the gas lines will be gone this summer.

Mr. MOFFETT. So you disagree with Secretary Schlesinger on that point.

Mr. O'LEARY. No. Secretary Schlesinger said he thought things would be better. That doesn't mean necessarily the gas lines will be gone.

Mr. MOFFETT. Did you see him live from Tokyo? A reporter asked him if they would be gone, and he said he thought they would be gone by the summer. Do you agree there is no need for rationing?

Mr. O'LEARY. I think rationing is an alternative that ought to be considered. Many people would feel comfortable if they had the certainty of rationing without the uncertainties of the gas lines, but, on balance, I think we are affecting with the lines a relatively small part of the total population. Many people are unaffected by it, but it may be that we ought to look at that more seriously, unlike what Congress did the last time around.

Mr. MOFFETT. I strongly see the need for standby rationing and continue to work along those lines. I think you would be well advised to stop complaining about Congress not passing it. A lot of us were disappointed, but hopefully we can get something that resembles a sound rationing authority.

I wonder if you would like to come to Connecticut next week and stand in an auditorium with me, if you can adjust your schedule, and make the statement as you did on page 4, that the public appears to have accustomed itself to fall and summer gasoline supplies at levels that will permit refiners to maximize their yields of middle distillates. Do you really believe that? You have been briefing members from all over the country and that is to your credit. Do you really believe the public appears to have accustomed itself to a falloff in gasoline supplies?

Mr. O'LEARY. I think we have a very, very severe situation in some parts of the country, including your own, but, by and large, I think most people are recognizing that they are going to have to change their habits. That was the intent of that sentence. We are seeing changes. For example, my understanding is that the mass transit system here is running at capacity. That is a thing it never did before. That is a change in habit. I understand the traffic over the bay bridge is 20 percent, weekend to weekend, down from where it was last year. That is a change in habit. We understand the carpool lanes are much more heavily used than they were a month or two ago. That is a change in habit. What I was saying there was not a holier-than-thou speech. You know me better than that. It was a statement that I think people are now beginning to see that they will not be able to conduct themselves as they did in prior years. There is a constraint on the system, and we are going to have to adjust.

Mr. MOFFETT. I think that is true. There are some positive changes people will have to make in their lifestyles. I would not be thrilled by the traffic cut on the bay bridge that much. It means tourist industries are going down the tube, and we are headed for a recession.

Mr. O'LEARY. I am not thrilled by it, Mr. Moffett. I offer that as an observation.

Mr. MOFFETT. I look at the testimony, and it is rather disheartening because you and I have been discussing, debating and arguing heating oil for a long time. We see you begin with the good news section and your telling us that distillate stocks stood at 135.4 million barrels as of June 22. You told the Joint Economic Committee earlier this week that we cannot look at a single week because it doesn't tell us all that much.

Mr. O'LEARY. I think that is right.

Mr. MOFFETT. But now you are hailing it as good news in your testimony that the industry reports the increase in crude imports occurred this week because a series of tankers happened to arrive during the same week. So that is rather troubling. Now, the thing that is most troubling, you may have heard reports on yesterday's hearing about this 230 to 240 million barrel target level. I think any reasonable person sitting here through the hearings yesterday or sitting through the hearings Tuesday before my subcommittee, would have to say that there is grave doubt, to put it mildly, as I think the Watson memo shows, that the 230 million barrel goal by October 1 is going to be met. It is based on five assumptions, as you know, all of which, not some of which, but all of which, have to be met. Imports must be 150 percent of last year's level. That is one assumption. Now, they are running at 104 percent, aren't they?

Mr. O'LEARY. No. Last week, they ran at 130 percent.

Mr. MOFFETT. They are below your assumptions, though. Every week we get behind, the 230 target looks less and less achievable. The same memo says one of these assumptions that has to be met is that we need a distillate buildup of 826,000 barrels a day. For June our inventory buildup was 464,000 barrels per day?

Mr. O'LEARY. Mr. Moffett, no, that deserves a response now. We deal with these things on averages, and we say to ourselves, we have so many days: 100 days, we have so much to go, 84 million barrels. We divide 84 million barrels by 100 days, and that is 840,000 barrels a day. But you know that right now we are trying to bend to meet the distress in, among others, Connecticut, from gasoline or certainly not make it any worse. We could tilt over right now and really make the situation much more critical in Connecticut. The refiners can do it technically. They can tilt away from gasoline and probably go from today's 22 to 23 percent middle distillate yield.

Mr. MOFFETT. I understand that.

Mr. O'LEARY. But why do you raise it and scare people? We are going to heavy up on this toward the end. You take an incident in the system, and you make it into a scary tale for people.

Mr. MOFFETT. Wait a minute; we are taking your memo, the Watson memo that you withheld from the subcommittee for 3 weeks which is a bad news, not a good news, memo that says the assumptions need to be met. What we are trying to do as Representatives is not scare people.

Mr. O'LEARY. Mr. Moffett, you are taking that out of context. It says that you have to have an average of 840,000 barrels a day over this period of time, and let me tell you, you can achieve that by having for the last third of the period a buildup of 2.4 million barrels a day. You know, there are many ways to skin this particular cat.

Mr. MOFFETT. I understand that, but you know the assumptions. There are five assumptions, and your memo indicates—I am not making this up; it says under each of these five assumptions that there is a problem.

Mr. O'LEARY. Of course.

Mr. MOFFETT. It is not that we invented this.

Mr. O'LEARY. If there was not a problem, we would not be sitting here having this hearing. We recognize the problem. I started this thing 3 months ago, Congressman Moffett, when I think no one else in the country was aware that winter was coming.

Mr. MOFFETT. Wait just a minute. I think there are a few other people that knew that winter was coming. Last year, you promised to have a hearing on heating oil in January after Mr. Goldstein came out and said we ought to have one since there is a real problem here on price, and we ought to have controls come back in. The hearing never really took place. There was never a hearing in January. Now, let's talk about who is going to be paying attention to this.

Mr. O'LEARY. There was a prehearing conference and the consumer people said they were not prepared for the hearing and it was postponed at their request.

Mr. MOFFETT. Has it been held?

Mr. O'LEARY. I don't know whether it has or not.

Mr. MOFFETT. It would be nice if we knew. The point is you made a promise to hold a hearing, and it has not been held.

Mr. O'LEARY. Let me address that. I had a prehearing conference. The consumers came in and said let's not have a hearing and we said fine.

Mr. MOFFETT. But the adjudicatory hearing you promised to hold was held. DOE came in and said we are not going to take the results from this hearing. We don't think it was a fair hearing. We are going to have to hold another one. It was never held. The recommendations were not taken. We let distillate stocks go down. You are saying we are still going to take actions for refiners. You say we are going to meet the 230 or 240 goal, if industry does its part. But they are 21 million behind last year's inventory level. We had Arco and Cities Service in here yesterday. Arco said the industry would reach 190 to 200 million barrels by October. That is 45 million below your goal. Cities Service said in order to get by the winter, we will have to have 15 percent conservation on heating oil. It is very doubtful whether we will see that. I think your previous testimony in a variety of committees indicates that. We are not trying to scare people here. I think that is really unfair. I understand that part of your tactical approach to this is to remain calm so we don't have panic in the country, but, we are on the brink of a distillate war here. I don't think that is an overstatement to say that. How many more snipers do we need on the highways to make this evident? How long a strike do we have to have in the country? How much of a recession do we have to be headed into? How many millions of barrels of wheat have to sit in

Minnesota with no available distillate to ship them out? You know we have an obligation here as Representatives to try to get some attention to these things. The DOE is saying they are prepared to take action. Arco said they have not heard from you at a high level yesterday. You know a lot of our fuel people in New England say the jawboning you are talking about is going on at the 32d tier of DOE to the 32d tier of Amoco, Arco, and Mobil.

Mr. O'LEARY. Yesterday, on that point I had both Amoco and Mobil in. I am the second tier.

Mr. MOFFETT. Has Secretary Schlesinger had the presidents of the companies?

Mr. O'LEARY. Yes, he has. He and I are both involved in a series now of bringing in the chief executive officers of the oil companies. He was with three or four or six last week. I have been with three this week.

Mr. MOFFETT. Is Arco invited to come in and talk about heating oil?

Mr. O'LEARY. They were in May 8.

Mr. MOFFETT. Who did they meet with?

Mr. O'LEARY. They met with Mr. House's deputy.

Mr. MOFFETT. That is the point, with all due respect to Mr. House's deputy.

Mr. O'LEARY. Mr. House was pointing out that this week the situation in Connecticut is a lot better because of the activity of his office. He was at that point probably trying to do something about the situation, but I want to tell you that I have talked—I am now, since this emergency began, in my third cycle of discussions with chief executive officers or other senior officers of the 18 or 20 largest companies in the United States. I have probably had something over the last 100 days approaching 50 discussions with officers. That is largely in the jawboning mode. I want to go back, however, and cover the point that you made with regard to our breach of faith on the January hearing. Indeed, I stood before this committee, before your committee, and I did promise that we would hold a hearing on middle distillate in January. We held a prehearing conference in January. You will recall that the entire objective of this was to serve the interests of consumers. Prior to that, we had provided funding with a lot of opposition within the Congress to intervenor groups representing those consumers. We provided about $100,000 for them to prepare the case before you and before me at that time. I did have that hearing, or it was had in the form of a prehearing conference in January. At that point, the consumers indicated they were unprepared to go forward, and there was nothing for us to do. They were the ones that brought the action. We are now waiting presumably for the resumption of that upon their readiness.

Mr. MOFFETT. You made a promise to myself and the subcommittee that you were going to hold the hearing. Now, you are telling me that the consumer groups were not prepared.

Mr. O'LEARY. I held a prehearing conference, and they were unprepared. I can't do any better than that. With regard to the scare talk, I think the repetition of these statements that people are going to be cold and herded into high schools and that sort of thing this winter is totally irresponsible, given the situation in which we live. It scares people. We have enough uncertainty and fright out there right now. We are not going to get to that point. You know when you get right down to it, you can close offices if you have to. You can cut them way down below 65 degrees. There are a lot of things we can do to streamline the truckers who borrow from that same barrel. We can knock off other than priority flights from others who borrow from that same barrel and will have enough oil for householders without that inconvenience. When we say to people who are already frightened of the situation that we are going to herd you into high schools, et cetera, Congressman, I have to tell you that it is not true. It frightens me to hear that kind of talk from responsible sources, and it provides a totally wrong message for the American people.

Mr. MOFFETT. One of the things you are doing, Mr. O'Leary, is, first of all, you are waiting far too long. Everybody knows that.

Mr. O'LEARY. I don't know that at all, Congressman.

Mr. MOFFETT. Are you going to wait until it all comes down on you in September or October? You are saying, here's the problem; here's the distillate problem; and here's the home heating oil part, and you are saying you will do anything possible to solve this part by exacerbating the problems in the other parts. We know that is coming. You couldn't answer to Mr. Eckhardt that there will be enough diesel. There probably won't. I am glad you are reassuring me on heating oil, but it is going to come down on your head and our heads.

Mr. O'LEARY. Congressman, I am glad you brought that out. Indeed, it is coming down on our head. It is coming down because a whole bunch of Congressmen and a whole bunch of representatives of the executive branch over a whole bunch of years have been somewhat short in total responsibility in handling this problem. Let me tell you why we are sitting here. It is not because we goofed or the oil industry is dishonest in looking at its own interests. It is because you, the Congress, and we, the executive branch, have been enormously shortsighted and have placed this country at the mercy of OPEC. When we say somehow or other we should be foresighted, the foresightedness is this: We can tell the gasoline users in this country we are now going to cut you off, including the Connecticut people; we are going to cut you back an additional 10 percent in addition to the 10 percent you are cut now; I think you say we should do that in order to avoid instability this fall. Now it is just really a tirade of instabilities. The basic fact is this country has a million barrels a day less crude. I heard this point a moment ago of Mr. Ottinger's that we are importing more, and indeed we are importing 300,000 more barrels a day than we did last year. He knows because I have told him that we are doing that because we were drawing down stocks last year so we don't have those stocks to draw down. The oil industry for its own purposes didn't like to have a fat stock position and drew its product stocks way down. And we entered the Iranian revolution with a critically low stock position here. That is ancient history. We are where we are. We have to import not simply more but a lot more because in addition to the fact that we don't have those stocks to draw on, this country has grown. We would like to have 3 percent more oil than we are using. Right now, at this point in our history, if you can believe the

May statistics, we use 1 million barrels a day less than we did May a year ago. Last year, it was 18 million barrels. This year, with everything running pretty much wide open, importing as much as we could find on the world market, it was only 17 million barrels. Now, that is the absolute fact here, Congressman Moffett. The fact is that there is not enough oil to do all the things that we would like to do.

Mr. MOFFETT. I understand that.

Mr. O'LEARY. What you are proposing is that we go in there and say, let's cut gasoline supplies another 10 percent. My own judgment is, you don't do that until you are absolutely convinced that you must. But if you must, you do.

Mr. MOFFETT. Mr. Brown?

Mr. BROWN. I just want to observe that we have been here now 1½ hours, and two members have had the opportunity to ask questions, and we have three subcommittees meeting here. I would say to you that if we were in the church at the point of your comments just now, the bells would have rung, because that is an important point. But I feel like some of the rest of us ought to get the opportunity to make some points one way or the other. I wish we were under the 5-minute rule. I guess we are not, so we probably will be here until Monday morning. But are we going to share the time at all?

Mr. MOFFETT. As you know, this gentleman was not chairing the hearing until 12 minutes ago. I would suggest the gentleman is on his time right now.

Mr. BROWN. But I am not next. There were two other members ahead of me.

Mr. MOFFETT. When the gentleman from Texas left, he said you were next.

Mr. BROWN. I am delighted. Let me ask some specific questions if I can, Mr. Chairman. First, this is an effort to bring about light, so I am sure it won't be necessary to record any of this. To what extent can DOE cause adjustments in the percentage of gasoline or heating oil to be refined out of an average barrel of crude oil in our society? Now, as I understand it, that depends on at least a couple of things. One is the kind of oil that the crude oil is; in other words, you have sweet and sour crude oil, low sulfur and high sulfur content. It also relates to the technical capacity of the refinery to be able to produce it. Some refineries, so-called refineries, only produce asphalt, which isn't going to help anybody in heating or help them drive to Rehoboth. How much difference in heating oil or gasoline can you cause the refineries of this country to make by the orders and the authority which you have?

Mr. O'LEARY. By a combination of three things, forgetting all about economics, forgetting all about who owns the crude and who owns the refineries, by just simply going in and allocating the kinds of crudes to the refineries that have the capacity that I am discussing here and by really sacrificing production of gasoline, you could probably take the average that is now in the range of 21 or 22 percent and push it up to 30 nationally.

Mr. BROWN. In other words, 22 percent of the barrel.

Mr. O'LEARY. Twenty-two percent of the barrel and push it up to 30 percent or maybe even a higher fraction. I talked to some refineries who say they could go to 40 from the existing rate of 20.

Mr. BROWN. Is that the average swing of production around the country?

Mr. O'LEARY. No. The average swing now that can be done by keeping some semblance of optimization of their economics is around 25 to 23½. We are toward the middle point of that now.

Mr. BROWN. When you get up to 40 percent, you have to throw away what is left in the barrel so it is wasteful of crude oil.

Mr. O'LEARY. That is right.

Mr. BROWN. You have this 3-percent swing that you can increase or decrease the amount of gasoline or heating oil.

Mr. O'LEARY. And probably you can stay without wasteful practices and some loss in economics with a 5- to 6-percent swing.

Mr. BROWN. The other thing that has happened is that you have had a change in the amount of crude oil that comes into the system. Because of Iran, we lost 5 percent for awhile.

Mr. O'LEARY. The crude we are getting into our system has been, over time, getting heavier and more sour.

Mr. BROWN. What does that mean? Nobody out there cares about this, but maybe the committee ought to hear it.

Mr. O'LEARY. It means simplistically that a given refinery can produce less gasoline and middle distillate from the crudes we are beginning to get in our system.

Mr. BROWN. When you lose Iranian crude, it means the capacity of the refinery goes down.

Mr. O'LEARY. No; the capacity to have high, light, and yield goes down.

Mr. BROWN. What I mean is that they will turn down their production a little because they have less crude oil coming through?

Mr. O'LEARY. No. Let's go back to your predicate. In the refinery, when the intake pattern changes, when the crude becomes heavier——

Mr. BROWN. You are missing my point. We lost some crude.

Mr. O'LEARY. But we replaced it.

Mr. BROWN. You didn't replace all of it.

Mr. O'LEARY. We more than replaced in a sense because imports are up from what they were last year.

Mr. BROWN. That has taken a little time. There was a slack period. Then also the quality of what you got in the system changed so you could produce less gasoline and less distillate oil; isn't that correct?

Mr. O'LEARY. Everything else being equal, we have lost a little capacity for the production of gasoline and distillate. I might say there are a lot of variables: The leaded phasedown, the use or nonuse of MMT.

Mr. BROWN. Don't make it too confusing. I want to make a few simple points that people can understand.

Mr. O'LEARY. When you make a simple point, you may include a complicated counterpoint.

Mr. BROWN. I understand unleaded takes about 9 percent more crude to refine than regular gasoline. I don't want to get into too much of that. People can only absorb so much in this business in terms of education. We have already burned up the television cameras.

Lets talk about distribution. How do you make a determination of the distribution of gasoline and middle distillate for agricultural purposes, for instance? It would seem to me, based on a little background of my own, that when a farmer goes in to plow a field that is rather wet, he probably consumes more oil in that process than he would if the field were somewhat dry; correct?

Mr. O'LEARY. My background does not parallel yours.

Mr. BROWN. Let me try another one.

If you disk the field twice, I don't know whether you understand what I mean by disking a field, but if you disk the field twice when you are preparing it for planting, it takes more oil than if you only have to disk it once. That relates to the moisture.

So it may not be totally possible to predict how much is going to be consumed in the preparation of the same acreage for the same production 1 year after another unless you can fully anticipate the weather patterns; right?

So we have at both ends of this not only a production problem but a marketing problem.

Now my question is this: How early should the DOE start urging the increase of the production of distillate over gasoline this year, based on the quality of the oil that is coming into the refinery capacity of our country, based on the capacity of the refineries to deal with that oil, and based on the anticipated need and the fact that your inventories are very far down?

It occurs to me that it makes a lot worse headline if somebody freezes to death in New Hampshire because they don't have heating oil, particularly if it comes a couple of weeks before the primary, than if somebody doesn't make it to Rehoboth because they ran out of gasoline.

Now what is the date of the switch? When do you start asking refineries to produce more distillate than they are producing gasoline?

Mr. O'LEARY. I answered the chairman when he tried to pin me down as to a date of when you do mandating by saying there are a number of variables. I will answer you in the same way. That depends upon your stock position, crude, and product. It depends upon the time of year in which you are involved. It depends upon the outlook for crude imports. It depends upon how we are doing with regard to distillate imports. There are a lot of variables.

Mr. BROWN. I tried to make those points in my question.

The question is: Do you start earlier this year with that swing?

Mr. O'LEARY. I think that in this sort of a year we are probably going to start later than normal because we are in such bad shape on gasoline. You know what we are doing here is saying to ourselves, what do we do? Do we really at this point go deeper into disruption? We are down about 9 points on gasoline supply.

Do we at this point go far away from that, assuming stable runs in favor of distillate, or do we get deeper into the driving season and tilt deeper?

My view is that what we ought to do is not go much below the current 9 percent reduction to gasoline. We should utilize the fact that we are going to, apparently on the basis of our shadow forecasts, the petroleum watch, we are going to experience an increase in imports and we will be better able to afford a significant switch over to middle distillate by the end of June than we would have been able to by the end of June.

Mr. BROWN. Finally, I am concerned about the rule 9 question, and then I would ask if it would be possible for Mr. Marks to ask a question before he has to leave.

But I am concerned about the diesel switch. I understand why because of essentially the farmers have gotten their planting done you have now switched the priority for diesel over to trucks and to the transportation system.

Mr. O'LEARY. No; we simply took away the priority on diesel.

Mr. BROWN. But that increases the amount of diesel presumably available to transportation, does it not?

Mr. O'LEARY. It does, but it does not mean we are giving priority to diesel.

Mr. BROWN. You will have a problem beginning at least in my part of the country in September. It may start in the northern States a little earlier, late August, where the farmers will have to have some priority in order to get their diesel to get the crops out of the field and ready for distribution.

What is the circumstance at that point, though? Do you expect to reinvoke rule 9 to be sure that they have enough diesel?

Mr. O'LEARY. Mr. Chairman, we intend to see that they have enough diesel, but that may fall substantially short of the reimposition of rule 9.

Mr. BROWN. Mr. Chairman, I would like to yield for my last question to Mr. Marks.

Mr. KOSTMAYER. Mr. Chairman, if I could interject, are we under the 5-minute rule?

Mr. ECKHARDT. I have been very generous to all who have spoken and I intend to do so with Mr. Brown. If he intends to yield for a question, that would be suitable.

Mr. KOSTMAYER. I would just say we have been here 1½ hours and we have heard from three people. There are other people here who would like to ask questions.

I am sure Mr. O'Leary has places to go, too. I wonder if we could move along a little quicker. I appreciate the gentleman's generosity.

Mr. ECKHARDT. Mr. Brown has yielded to Mr. Marks. Mr. Marks is recognized.

Mr. MARKS. I am sorry, Mr. O'Leary, but I won't be able to question the gentleman for too long, as I have to go to another meeting.

Having heard you say that the President of the United States has directed you to see that there is home heating oil, the question we all want to know is: Will the American people this winter have enough home heating oil to heat all of our homes? Can you guarantee us that today?

Mr. O'LEARY. Mr. Marks, I can guarantee you that, give you total assurance of that with one exception. If there is another significant supply interruption——

Mr. MARKS. What would be a significant supply interruption?

Mr. O'LEARY. If, for example, the way the world is now configured, if there was a resumption, for example, of the Iranian revolution that had the effect of stopping crude production, if we lost another 4 million barrels a day for a long period of time, then we may not be able to have it.

Mr. MARKS. Other than that, can you think of another situation?

Mr. O'LEARY. If the situation remains as it is today, the priorities are such that I can assure you that there will be sufficient heating oil generally. Now there may be interruptions because of weather this winter or mislocation of stocks, but I can assure you that there will be adequate heating oil to reach a normal or worse than normal winter.

If there is a 300-year winter, it may be beyond the capacity of the supply system to keep up with it. But within the bounds of normality to the sorts of things we have experienced, even in the last 2 or 3 years, we will be able to make it.

Mr. MARKS. I thank the gentleman.

Mr. BROWN. Let me suggest, though, that that suggests two things for the American people.

One is they better watch the weather map and the international news because if the Iranians go down or somebody drops three ships in the Straits of Hormuz in the Persian Gulf, we could be in serious trouble.

Isn't it true that about 40 percent of our capacity comes from Moslem nations around the world?

Mr. O'LEARY. The oil for about 40 percent of our capacity does come from them.

Mr. BROWN. So we have a problem in case somebody decides the United States should not receive their oil, even though we are willing to pay the exorbitant prices for it.

Mr. Chairman, I thank you. I think it would be wise if you could get into with this group some time into banked costs which have a great deal to do with how much the prices have gone up, the fact that they have gone up really higher quite legally, really higher than the crude oil shortage situation might require them to do otherwise.

But we don't have time for those questions now.

Mr. O'LEARY. May I make a further point with regard to refinery yield patterns, Mr. Chairman? It is an important one. We are now sitting with about 135 million barrels of stocks and we want to get into the 230 or 240 range. A 2-percent switch beginning toward the end of this month would take us into that range.

We are not really talking about a dramatic change. We are talking about a 2-percent switch, going from, let's say, 21 percent up to 23 percent. That will add sufficient stocks at the end of the period to get us into a comfortable level. That is why I am confident that we can make it.

Mr. BROWN. Mr. Chairman, I would ask unanimous consent, if you will suffer me one other comment before I yield, to put into the record the Lundberg letter of June 22, 1979, which does explain the point I just made about the banking of cost margins and may be helpful to other members of the committee.

Mr. ECKHARDT. Without objection it will be entered at this point.

[The information follows:]

L U N D B E R G   L E T T E R

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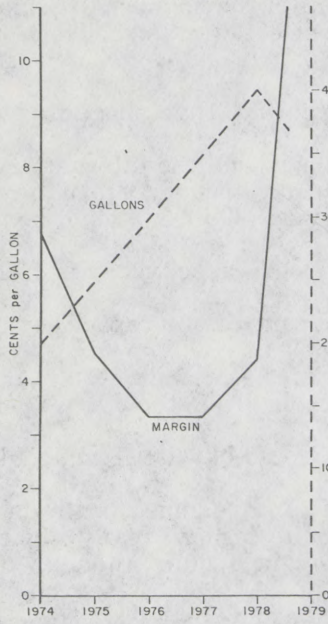
Federal Gasoline Regulations

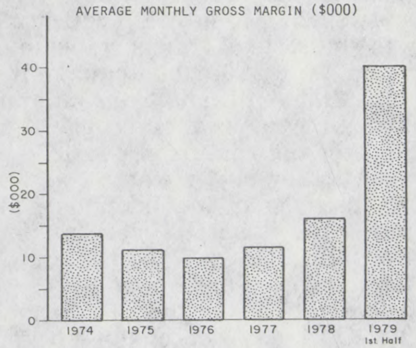
What the Public Doesn't Know

VOLUME OPERATOR'S OPERATING HISTORY, 1974-1979

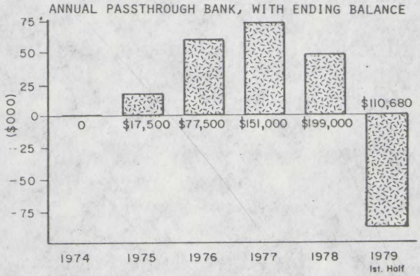
AVERAGE MARGIN AND MONTHLY GALLONAGE



AVERAGE MONTHLY GROSS MARGIN ($000)



ANNUAL PASSTHROUGH BANK, WITH ENDING BALANCE



PASSTHROUGH banks permit sellers to recover later whatever they were unable to make below their base-period margins. Thus maximums becomes minimums too. Whatever the government sets as the ceiling, the public will eventually have to pay, under present and foreseeable conditions. Two hypothetical case histories are examined to show how this works. The volume operator developed high gallonages on low margins (left). Passthrough banks (bottom right) allowed him to make extraordinary gross margins this year (top right). The other case is on page 2.

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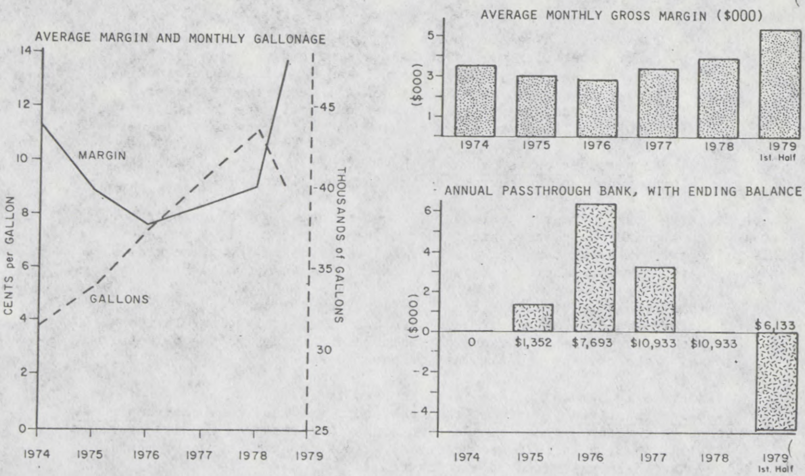
HYPOTHETICAL CONVENTIONAL DEALER'S OPERATING HISTORY, 1974-1979



FEDERAL GASOLINE REGULATIONS

WHAT THE PUBLIC DOESN'T KNOW

WHAT the public doesn't know about federal gasoline price controls is that, in addition to being ceilings, they are in effect minimums. What does this mean? It means that while the public is preoccupied with the supposed benefits of restrictions on price increases, it doesn't realize that the system assures that in the long run it will pay the full amount of whatever the government sets the ceiling to be.

While controls are in force, forget about competition bringing lower prices.

How can this be? We all know that competition has forced gasoline prices below ceilings for long periods since the present ceiling programs went into effect in December 1973. True, but there's a "banking" provision that allows sellers to raise their prices above base ceilings to get back what they weren't able to get because of competitive conditions.

Banking is what transforms ceilings into minimums, as if by sleight of hand.

Here's briefly how ceilings and banks work. So-called price ceilings are actually margin ceilings. A retailer's ceiling is the margin he was making on May 15, 1973 (base date), plus his current buying price. Since March 1, 1974, he has also been able to add a maximum of 3¢ gal. to cover nonproduct cost increases (such as utilities, labor).

A "bank" is a calculated amount of money that can be accumulated whenever a retailer prices so that his margin is below his base margin. If his May 15, 1973, margin was 7¢ gal. and he's making only 5¢ gal., he can bank 2¢ gal. on all he sells at that price. That is, he can save it against the possibility he can pass it through later if competitive conditions permit, as they do now.

<u>The nonproduct costs cannot be banked</u>. If they aren't passed through during the current month, they are lost.

Such "banking" can do magical things. The cut-price, high-volume operator, so much appreciated by price-conscious gasoline buyers, can legally recover his price cuts when the traffic will bear it. This is taking place widely now, when the gasoline shortage curtails competition and permits higher prices.

Is this some sort of distortion of ceiling regulations brought about by unforeseen circumstances? No. Remember that ceiling regulations were imposed precisely because of shortage. Shortage is the climate in which the ceiling program was intended to work.

Neither is it something that just happened to fall into the laps of <u>gasoline retailers</u>. <u>Refiners</u> can bank, too, and they can bank <u>nonproduct costs that retailers can't</u>. Refiner banks that amounted to well over $1-billion early in 1978 are reportedly almost nonexistent now, meaning they have been passed through to customers.

<u>Retail Banks: Two Case Histories</u>

Perhaps the only way to understand how ceilings become minimums is to examine how sellers operate under regulations. We will look at the histories of two hypothetical gasoline retailers. The cases chosen will also permit us to see how regulations punish the weak and reward the strong.

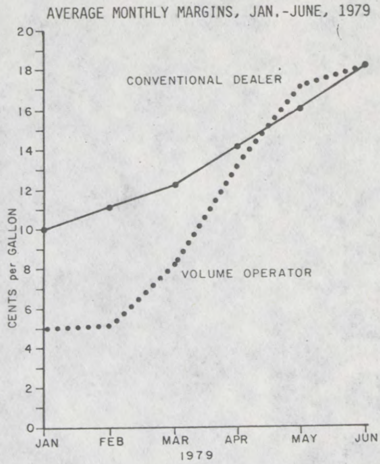
1

CONVENTIONAL DEALER -- This hypothetical case is meant to be somewhat representative of the mass of lessee dealers in the country. This dealer prices with the pack, and he enjoys average growth as stations close by attrition and as overall gasoline sales increase.

On May 15, 1973, he was making an average of 9¢ gal. on all grades, full-service. He was better than average in this respect.

On Jan. 1, 1974, when the government gave retailers their first 1¢ gal. of nonproduct-cost passthrough, he raised his margin to 10¢ because he could. There was a gasoline shortage caused by the Arab oil embargo. In March he took another 2¢ gal. nonproduct-cost passthrough allowed by the government, and he was making 12¢ gal.

This was a bonanza. He and other retailers knew it. His base-period



margin of 9¢ gal. was good in itself. Before 1973, his margins had been almost always below this so-called "normal" or restoration level that came after a price war. Frequently his margin had been at the bottom or "stopout" of 4.5¢ gal., which his supplier supported to keep him from going broke too fast.

But after the embargo ended in March 1974 and the summer passed, gasoline supplies began to loosen up and he had to give up a penny of margin in September. In April 1975 his margin deteriorated another penny, and in September another penny, putting him at 8¢, 1¢ gal., below his base-period margin.

Somewhow this dealer had found out about passthrough banks. Maybe a friend of his was a government auditor. He kept the documents together, thinking at the time it was practically pointless because he didn't see how he could ever get margins over 12¢ gal. He didn't know a gasoline shortage would hit more than four years later.

In June 1976 competition got so bad in his market he had to shade his margin to 7¢, giving him 2¢ gal. bank for five months. He banked what he thought was a tidy amount of $3,730 during the period.

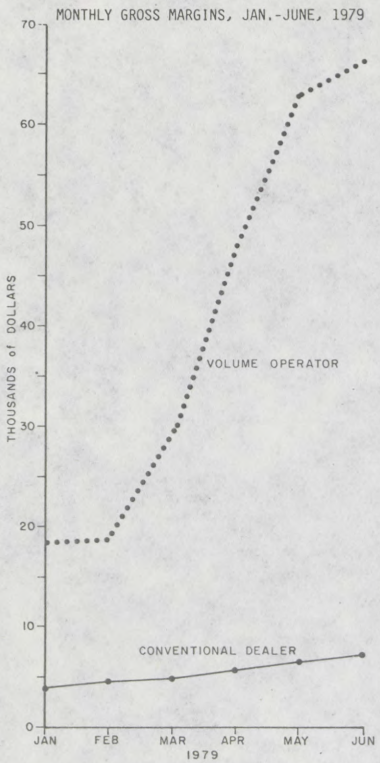
In November he was able to increase his margin to 8¢, and in September the next year 9¢. That's approximately where he stayed until January of this year, when tightening supplies firmed prices.

By March, the first month of general nationwide gasoline allocations, he was back up to his 12¢ ceiling and needing it. The 12¢ margin that had looked so good early in 1974 had been severely undercut by five years of inflation and higher operating costs.

In April, prices were climbing so fast he saw an opportunity to draw on his passthrough bank, which totaled $10,933. He increased his margin to 14¢, passing through 2¢ gal. In May he passed through another 2¢ gal., going to 16¢ gal. margin. This was more like it. In June he went to an 18¢ gal. margin, passing through 6¢ gal.

He figured he would have a passthrough-bank balance of $6,133 by the end of June, and that he could continue to get 18¢ gal. margin until past the middle of September before he ran out. If only the shortage held.

The graphs on page 2 show this hypothetical conventional dealer's operating history from 1974 through the first half of 1979. His average margin and monthly gallonage are shown at left. Top right are his average monthly gross margins, and bottom right his annual passthrough banks. The baseline is the



accumulated balance. The bar at right shows how much of his bank he passed through by the end of June, and the balance in his bank.

You may be beginning to think this hypothetical dealer has a pretty good deal now. There are some pluses, no doubt, but now let's look for comparison at a hypothetical volume operator.

The graph on page 4 shows average monthly margins this year (January through June) of the conventional dealer and volume operator. These are quite different at the bottom, but comparable at the top. Both end up at 18¢ gal. in June.

But now compare gross monthly margins of these same retailers in the graph on page 5 for the same period. The conventional dealer's monthly gross climbed from $4,000 in January to $7,200 in June, but the volume operator's soared from $18,400 in January to $66,240 in June.

The time has come for us to examine the case of the volume operator.

2

VOLUME OPERATOR -- This hypothetical case is meant to be somewhat representative of the skilled low-margin, high-volume retailer. This one happens to be self-service, but he could be miniservice or gas-and-go or whatever so long as his operation could handle 400,000 gal. a month.

The volume operator sets his gallonage targets and achieves them by cutting price and margin. This case is not extreme. The 3¢ gal. margin on which he operated 15 months in 1976 and 1977 is by no means as low as some volume operators have gone. The volume is the thing. Operating costs remain relatively fixed, and higher volumes bring in more dollars. Toward the end of this long, low-margin period he was grossing $12,000 a month.

Neither is the 400,000 gal. a month extreme. The accumulated bank is plausible and consistent with reports of actual documented banks.

This example is conservative in many respects. The volume operator is living entirely within supplier allocations, just as the conventional dealer did. He receives no exceptions for growth, either individual or class, and he gets no gasoline from other sources, like brokers or other outlets in a chain.

In fact, this volume operator does not enjoy any of the flexibility and special opportunities possible in a chain. This one enjoys no chain leverage, although perhaps some is implied in his ability to build and hold these volumes without being bumped around by a chain competitor.

The graphs on page 1 show the volume operator's history from 1974 through the first half of 1979. His average margin and monthly gallonage are shown at left. Top right are his average monthly gross margins, and bottom right his annual passthrough banks. The baseline is the accumulated balance. The bar at right shows how much of his bank he passed through by the end of June, and the balance in his bank. (Note that these graphs contain the same data as those on page 2 for the conventional dealer.)

Here's a brief summary of the volume operator's history.

During the Arab embargo, he took his maximum 6¢ gal. ceiling (all grades) in January, and his 8¢ gal. in March.

In June, supplies were looser and volume became a consideration, so that he cut his margin to 7¢ gal., embarking on what was to be a sustained pursuit of his volume objectives for the next four years.

In June 1975 he cut his margin to 4¢ gal., theoretically beginning a passthrough bank. He didn't happen to know about passthrough banking then, but his records were good and he was able to document the bank when the time came he could use it.

In July 1976 he cut his margin to 3¢ gal., building toward 350,000 gal. His volume grew nicely, so that in October 1977 he moved his margin back up to 4¢ gal. Although he held to that margin, he hit 400,000 gal. early in 1978 and averaged that for the year.

He inched up to 5¢ gal. in January of this year because of rising prices, and when allocations hit in March he raised to his full ceiling margin of 8¢ gal.

In April he passed through 5¢ gal. of his documented bank, with a margin of 13¢ gal. With his huge volume, even though somewhat curtailed by allocations, his gross margin that month was $47,840, of which $18,400 was bank.

He raised his margin to 17¢ gal. in May, drawing down his bank at the rate of 9¢ gal. In June he went to 18¢ gal. margin, with 10¢ gal. bank drawdown. Before beginning to draw on it, he calculated his passthrough bank to be $199,000, and he figured his balance the end of June would be $110,680.

If he continued to draw down his bank at the June rate of 10¢ gal., he could do so for almost exactly three months, if his allocation stayed about the same as it was in June. That would take him through September. If only the shortage held.

Summary and Conclusions

In both hypothetical cases, it appeared the retailer would recover everything he ever priced below his base-period margin (but not nonproduct costs). The volume operator was prospering and had a bright future. The conventional dealer was on borrowed time. Come September he would be back under the burden of five-year-old margins.

The Department of Energy is reportedly considering revamping federal ceiling and allocation regulations. One proposal under consideration is abandoning banks. Be that as it may, here's how the situation looks now:

-- Federal gasoline ceiling price regulations provide guaranteed margins under present and foreseeable conditions. This is because of banking provisions that permit product costs increases to be saved when not passed through.

-- When competition does drive prices and margins down, sellers can recover base margins later when competition eases, as is happening now with gasoline shortages.

-- Retailers can recover their base margins, but not nonproduct cost increases they can't pass through immediately. Refiners can bank both product and nonproduct cost increases, so they can get all price cuts back, as most have already done.

-- When fully understood, these regulations provide powerful incentives for price-cutting and volume-building, because what you give away in margin today you can get back tomorrow -- with the added advantage of volume.

-- Federal allocation regulations support these incentives by rewarding high-volume sellers with more gasoline during shortages.

-- Conventional dealers, who do not enjoy economies of size and who price conventionally, do not build volume, accumulate little or no passthrough banks, and suffer crippling allocated volumes in times of shortage.

-- The effect of these ceiling and allocation regulations is to punish the weak and reward the strong. The longer the regulations stay in place, the more conventional dealers will be driven out of business.

-- Most dealers have not documented their banks, but price as if they had. They can avoid detection, because enforcement is almost totally ineffective, by staying in the pack. How long this refuge will remain is unknown, but as long as it lasts it is necessary for their survival.

-- The eventual demise of many conventional dealers under regulations will decimate the national automotive-service establishment, which requires hundreds of thousands of service bays at conventional gasoline outlets.

-- Federal regulations are right now themselves causing some price increases that surpass anything that could be reasonably expected in a free market.

-- The public understands only the prospect of price limitation, does not realize these same regulations also guarantee margins, in effect, while creating eventual havoc with the basic service establishment.

-- Ceiling regulations program pricing objectives and help marketers anticipate actions of competitors, thus stifling free competition.

-- Gasoline marketing has become a game of playing the regulations. It is too late for the mass of dealers to do anything about their handicaps. They can only hope the game will be scratched.

Mr. ECKHARDT. Mr. Gore?

Mr. GORE. Thank you, Mr. Chairman.

Mr. O'Leary, I would like to return briefly to the question on domestic production. I have looked at your data. I think I understand what you are saying. We were making calculations on the basis of weekly and monthly energy reports. I see in the footnote that those reports themselves were made up of data taken from three different reporting streams.

I take it that your technical people, your statisticians, have told you that the effort to integrate those three data streams has produced some statistical anomalies.

So that you would directly challenge the conclusions drawn by the Associated Press in the recent stories on the decline in domestic production?

Mr. O'LEARY. I don't challenge them. The technical people do. In this, I am simply an instrument of the——

Mr. GORE. Do you?

Mr. O'LEARY. I believe my technical people understand the data. Their representations are that the AP simply misconstrued the data, and I think that is understandable.

Mr. GORE. I can see what you are saying and what they are saying, but the AP's interpretation coincides with the precipitous decline in the rig count, for example.

Mr. O'LEARY. I have somebody who knows what he is talking about here, Mr. Gore, if I can bring him into the debate.

Mr. ECKHARDT. Would you please identify yourself for the record? Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. PETERSON. I do.

My name is Jim Peterson. I am Director of the Office of Energy Data and Interpretation, EIA, with DOE.

The problem that you have with the numbers is exactly as you have identified it. The primary difference is within the timing of the numbers themselves.

The first set of numbers that comes out are those associated with the API projections.

The second set of numbers is EIA and DOE's effort to provide as soon as possible an indication of the direction and magnitude of change of the numbers, and those are published in the monthly petroleum statistics report. Those are the numbers that are quoted in the Post article this morning.

The third set of numbers which is the EIA final numbers, are those that Mr. O'Leary indicated, those that are derived from the State revenue and tax production information. The table that Mr. O'Leary introduced into the record is one which compares those series 78 and 79.

Basically, what they show is that the API is consistently high, the early monthly petroleum statistics report numbers which are derived from a first purchaser system are consistently low.

The reason being, there are certain oil production that is not subject to first purchaser, that is, royalty oils or USGS production, or oil that may be burned on lease site, so they never get into the first purchaser system. We do pick them up when we hit the 30-, 45-day time period.

That table that will be introduced into the record gives you those monthly differences. What it boils down to is 150,000 to 175,000 barrels.

Mr. GORE. Should we no longer put any credence at all in the periodic reports from the Department?

Mr. PETERSON. Certainly I would use them because I think they give you——

Mr. GORE. You just said they are wrong.

Mr. PETERSON. They give you over time, Congressman, the best information that we have on the direction and magnitude.

Now, recognizing timing is a very serious problem, we are, however, going to take a serious look at whether or not we might not derive some better estimates on that second level which you will see in the MER.

Mr. GORE. Can you say with certainty that the reports by the Associated Press on the dramatic decline in domestic production are not an accurate reflection of the current situation, or is your testimony simply that the information upon which it is based is unreliable?

Mr. PETERSON. From the information that we have available to us, it would appear that the differences during the last few months are not abnormally different from those that have occurred at this time of year in any previous year.

Mr. GORE. Is there any problem in comparing the data in the monthly energy review for October 1978 with February 1979?

Mr. PETERSON. Yes.

Mr. GORE. OK.

All right, fine. I don't want to use more of my time on that question. I think it is important to resolve this because if the data is not that way, then I think that is a significant clarification of the situation that we are in.

Now I would like to move on to the issue of distillate controls, Mr. O'Leary. In doing so, I would like to preface my question by saying that I would like to congratulate you on your presentation to the Democratic study group this morning. I thought you made a real contribution there.

Now, distillate controls, as everybody knows, are different from crude oil controls. That is a big political issue that is really separate from this one.

In calling for allocation and price controls on distillates, I don't want to give anybody the impression, and those of us who call for it shouldn't give anybody the impression that somehow that is a magic answer to creating more supplies. It is not at all. But it is a means of distributing the available supplies on a more equitable basis.

On the last page of your testimony, you say, "If we should reach the point where it is apparent that we will not have adequate supplies for the winter, serious consideration of the reimposition of the controls would be in order."

Now, the issue here this morning, very simply, is whether it is now apparent that we will not have adequate supplies of distillates for the winter, not whether people will be cold in their homes.

I personally am very glad to hear your statement that you are not, that the administration is not going to allow that to happen. I think that is a good statement for you to make.

But I am less than reassured by the premise that you attach to the statement that we will insure that no one has their home cold this winter, even if it means shutting down a substantial proportion of our economy in order to do it.

Now I think that you are saying, and I don't want to extend your remarks beyond what they were, but I think you are telling us that it is possible we could have a severe shortfall on distillate supplies this winter, and in any event you are going to make sure that no one has a cold home this winter, but that it is very possible that we would have to take distillate supplies away from other users in order to meet that promise; is that fair?

Mr. O'Leary. Yes. We are doing that right now.

Now the difference between taking away and taking away disruptively, of course there is quite a step. I don't really think we need have a serious disruption this winter. I think that we are going to have to slow down some uses as we are doing in distillate under orders right now as a result of the gas switching program.

But within those limits, if we can get the stocks up and if refinery runs are permitted to be kept high——

Mr. Gore. To be kept high?

Mr. O'Leary. To be kept high by crude imports, I think we will be in shape so we are not disrupted.

I think here, again, I have to be particularly careful, and maybe I was not, because I don't want to leave the impression that there is going to be disruption in the rest of the economy.

I simply say that our dedication to this proposition that people are not going to freeze in their homes is such that if need be, we will do that.

Now I don't see any chance of that at the moment.

Mr. Gore. Well, we don't use heating oil in Tennessee, but I think everyone in the Nation wants to make sure that those who rely on heating oil have it to keep their homes warm.

Now, can I tell my constituents with absolute assurance that we won't have to completely stop industrial use of distillate, that we won't have to completely stop the trucking use of distillate except for agricultural products, and that farmers will have the supplies they need in the harvest season?

I can't tell them that, that is the truth of it, isn't it?

Mr. O'Leary. Well, let me go over where we use the distillate and then you can draw your own conclusions.

Mr. Gore. OK.

Mr. O'Leary. There is a lot of space heating nonresidential in this, but it takes about 45 percent of the total distillate supply, so we are not talking about something that is 90 percent. We are talking about something a little under half.

The shortfall, what we are talking about is a 4- or 5-percent swing. So it is 10 percent of that 45 percent that is in question.

The next group are your industry and companies. They use 10 percent.

The next are electric utilities, and we have hit these people hard because you can substitute there, 6.2 percent.

Vessels and railroads, not a lot of choice, 10.8 percent.

On highway diesel, 21.5 percent. Off highway diesel, largely the farmers, 5.1 percent, and others, 2 percent.

So you know, we are probably going to have to tighten down on that whole column, but I can assure you that we are going to see to it that priority requirements are met.

For example, we are going to get the harvest out. We are going to get that harvest transmitted to market unless there are other disruptions. It will not be fuel that keeps it from getting to market.

Mr. GORE. Let me ask a basic question that illustrates my concern.

As companies seek to build their primary stocks, right now in some instances they are cutting off some jobbers entirely. Now if the State set-asides can't supply the distributors or jobbers, and there is no regulatory, no allocation scheme in place, then how are the customers that used to rely on those jobbers who are now cut off going to be served?

Mr. O'LEARY. Well, we have been forced to meet that situation in gasoline on a pretty major basis by assignment. We simply assign somebody with the product the responsibility to provide that product to the fellow who lost it to the customer.

Mr. GORE. They are not doing it. I have jobbers in Tennessee right now and there have been orders to people to supply them with oil, and they are not complied with. They can't get the oil.

Mr. O'LEARY. That is an order that is enforceable in the Federal courts. We have encountered some resistance in the past. The resistance is minor. I am sure you can cite examples, and I can, too, because you may be assured that I hear of them, but they are by the handful.

We do this routinely in hundreds and hundreds of cases and it works pretty well.

Mr. GORE. One final question——

Mr. O'LEARY. I am told we process about 2,000 of these cases a week, Congressman.

Mr. GORE. One final question: Let me conclude that I hope you are right in your projections. I worry that we are going to have a serious problem in September with the harvesting. I hope you are right that we get through it easily. I am worried that we will have it worse in January or February.

Mr. O'LEARY. I didn't say easily, I don't think. But we will get through it.

Mr. GORE. In your opinion, was the drawdown of stocks last year by the companies in the national interest?

Mr. O'LEARY. In retrospect, had we known that we were going to have a severe supply disruption and the consequences on availability of crude that have flown from it, the revised attitude of OPEC members with regard to their willingness to produce crude—you know, there is plenty of capacity out there as I said before.

Saudi Arabia could produce probably 1½ million barrels a day more than they are producing, but in retrospect, had we known all the things that were going to happen, I personally would have recommended intervention in that stock drawdown.

I might say that had the companies involved known that the Shah was going to fold and Iran was going to lose, that the Saudis would not increase production along with some of its associates in OPEC, that the Congress was going to be at the critical point of debating the withholding tax, going to be confronted with lines all over town, we probably would not have had to intervene.

Mr. GORE. Thank you, Mr. O'Leary. Thank you, Mr. Chairman.

Mr. ECKHARDT. Mr. McCloskey?

Mr. MCCLOSKEY. Thank you, Mr. Chairman.

I will defer my questions for 1 minute and yield to the gentleman from Texas.

Mr. LOEFFLER. I thank the gentleman for yielding. I have one question I would like to pose.

In Chairman Eckhardt's opening statement on page 2, he stated: "With extremely strong demand and sufficiently short supplies, prices of distillates along with gasoline are threatening to go to the ceiling."

It seems remarkable to me that the price of gasoline has risen so dramatically under controls. Would you address that particularly?

Mr. O'LEARY. Yes; I will.

I think that, first of all, you have to realize that we don't have in reality a free market in middle distillate and we don't have in reality a control market in gasoline.

Now that is the fact. Here is the situation:

From the very moment of decontrol, the whole system for middle distillate has been on notice that if they were not responsible, we would reimpose controls. I think that is quite clearly reflected in the way they have behaved.

For example, there was reference earlier to the Goldstein hearings. In those hearings we found that there had been from the time of decontrol until the time the data had been closed off, a 10-cent increase in the price of middle distillate at the retail level. We found that a half cent of that could be ascribed to overcharges, or that is to say, could not be accounted for by accountable increases in costs.

Mr. LOEFFLER. What about gasoline then?

Mr. O'LEARY. In gasoline as I say, we have controls, but the control system is so difficult in the individual case at the retail level. It works quite well at the refinery level, but we really can't be sure what the price is. We have in effect a continuum. You could have quite legal charges at five neighboring stations that range from $0.80 to $0.90 to $1 and $1.50.

It would depend on what the station happened to be doing on May 15, 1973, to begin with and it would depend on whether or not that station availed itself of a thing it arguably has, that is to say, banks. It may be that even the $1.50 price on that given day would have been legal taken into account that letter buying, assuming he could assert his entitlement to run a bank.

So we are in a situation where I think we do not really have a great dissimilarity in the way the market is operated. We are somewhat above what we would regard as the probable legal price on average, slightly, a penny or so, for gasoline and it is quite apparent that anybody who has middle distillate, were he completely undisciplined, could put it into the spot market and instead of making 72 cents last month could make $1.12.

Mr. LOEFFLER. So you are saying that in the price of gasoline, with the vertical change, there is no undue profit being acquired by anyone on the spot market?

Mr. O'LEARY. I have a chart here that will allow you to make your own judgment on that. Let me put that up.

This chart, which is also appended to my testimony, although in less beautiful full color, shows the best estimates that we can make today with regard to how the gasoline price is split up among the various elements. I think it is worth noting that this is a March number. Since then, the price has gone up about 8 cents. If you would like, I will tell you what has happened to that as of the end of May.

But you will see what has happened here is that we have had a runup which was then 3 cents and it is now about 5 cents in the crude contribution. We have had a runup of about 2 cents in the refiner-reseller contribution to the increase in cost. We have had 1 penny at the retail end of the business as of that time and the other exponents of cost, taxes, has been constant, Federal and State tax has been constant.

Now, let me give you the numbers from this vast stack of numbers that relate to May. In May the total had gone from 72.5 to 80.7. The crude had gone to 36.5. The refiner-reseller margin, quite legal, had gone to 19.8 because that is controlled and we can audit it. I think there is the least chance of slippage on these two components than the rest. The retailer component, 11.9 had gone up another 2 cents. The tax was constant, to a total of 80.7. We have gone up a couple of cents since then and it will creep up.

But you cannot see in this spread enormous price gouging. My own view is that the largest overcharges are probably at the retailer margin.

Mr. LOEFFLER. If I might interrupt you, I am on someone else's time and I ask that you submit this for the record. I think the gentleman from California.

Mr. O'LEARY. I am sorry, Representative McCloskey.

Mr. MCCLOSKEY. Why don't I just consider that it is Mr. Loeffler's time and I will defer the next time.

Mr. ECKHARDT. Mr. Ottinger.

Mr. OTTINGER. I find it very difficult to see how refinery runs are down because of a shortage of stocks. My information is that the drawdown of stocks was heavy but it was about 14.5 percent of 1977 stocks which were very high.

The thing which disturbs me most is your assumption and the Secretary's assumption that the oil companies are acting in the national interest in this respect and your unwillingness to really put the arm on them with respect to both domestic production and with respect to refining.

I would like to quote from the Washington Star, from a news conference that Secretary Schlesinger had on the 22d of June. It says:

> Schlesinger spent the first half hour of the press conference today defending oil companies. Following the defense, Schlesinger again expressed disappointment that refineries are not turning out more gasoline. When asked when he would force them to do so, he replied "I am reluctant to use allocation as an instrument of disciplining the supply because of the consequence it may have on the companies. They could defer importation and leave the crude oil on the high seas."

That says to me that we are succumbing to blackmail by the oil companies and have been unwilling to use the allocation powers that we presently possess with respect to because of fear of those companies. If that, in fact, is the case—if the oil companies in fact are making that kind of threat—then I think we ought to be moving toward nationalization of those companies. I certainly would consider putting in legislation to that effect.

Are we in fact yielding to blackmail on behalf of the oil companies?

Mr. O'LEARY. Congressman, I was not at the press conference and I don't know if that was accurately quoted or not, but let me give you my view. I have been quite active in a regulatory effort aimed at the major oil companies that has yielded notices of probable violation of about $5 billion at the majors, Exxon probably $1 billion or close to it. If I were frightened of retaliation in the form of denying product to the United States, I would rescind that effort. But what I am doing now is intensifying it.

I have testified here that I would have no hesitation in imposing yield or even switching crude from one refiner to the other in the event that the middle-distillate situation warranted it. So I really think that there is, first of all, no probability of the companies providing this sort of blackmail without our knowing about it. We would catch it statistically and second, we have sufficient power in this Government to make it very uncomfortable for a company that tried that sort of thing when we caught it, and we would catch it.

I think, knowing that, that the companies simply would not do it. I think you will find that Secretary Schlesinger at the proper time, will be quite willing to impose controls. I think that what we are seeing here is the situation where we don't believe that the time has come.

Now, let me tell you the dimensions again and I have spoken to you about this before about that drawdown potential. In our judgment, it is about 20 million barrels. The difference of opinion between the Department of Energy and the companies is a total of 20 million barrels. That would permit an increase in runs of perhaps 300,000 barrels a day throughout the remainder of the summer, and production of gasoline about 150,000 barrels a day against the shortfall of 800,000 barrels a day.

It doesn't cure the problem. In the middle-distillate terms, perhaps 75,000 barrels a day against what we have established as a need to increase of something like 10 times that much. Again, it does not solve the problem. So what we have then is a tactical point. We think that among other things, the companies ought to be out buying as much as they can on the world market and I think that by and large the majors are doing that, bringing as much as they can of that here, and I think they are doing that, running as much as they can and I think they could run a little more.

But if we add up all the disagreement, does it cure the disagreement and eliminate the lines? The answer is no. It is a tactical consideration, yes, but tactical and does not change the fundamental equation. The fundamental equation is not that we need to run down those stocks by 20 million barrels, it is rather that we need 1-million-barrels-a-day relief, not 300,000. That is only going to be available, unless we want to get ourselves in a relatively improvident position of really running all of our stocks down to the nub, where our economy is threatened, that is only going to be available if we can somehow or another increase imports.

Mr. OTTINGER. If the situation is as you describe it, then it would seem imperative that we move to gas rationing at the present time and have the mechanism in place to be able to handle it.

Mr. O'LEARY. We are rationing at the present time of a sort. The allocation system, as you pointed out earlier, is producing a reduction of gasoline consumption, not demand but consumption, of almost 10 percent.

Mr. OTTINGER. Now, I would like to clarify a question with respect to imports. In your estimate you say if crude oil imports are maintained at 6.2 million barrels a day and the refiners adjust their yield slightly in the face of tight gasoline supply to increase production, that we would have adequate heating oil supplies for this winter. You also say that if crude oil imports fall below 6.2 million barrels a day and refiners do not take the necessary action, we face a very real prospect of severe emergencies. The figures I have show that we have been running well above those figures of 6.1 or 6.2 million barrels.

Mr. O'LEARY. Yes. You have product and crude in your numbers, Representative Ottinger, and I was speaking and I now will speak only to crude alone.

There is a great deal of residual fuel oil that comes in, 1½ million barrels a day or thereabouts, and we do import some gasoline and some middle distillate.

Mr. OTTINGER. This 6.2 million barrels a day——

Mr. O'LEARY. It is crude.

Mr. OTTINGER. Is crude. The 8.5 million figure that I have——

Mr. O'LEARY. Crude plus product. Primarily fuel oil for use in every part of the country.

Mr. OTTINGER. What has been the import rate then of crude over this past year?

Mr. O'LEARY. That is depicted on this chart. It runs from 5 million to 8 million. 6.5 million is here. You can see we were down at 6 million.

The chart does show it, at about 5.9 on through April and May. It has turned up now to almost 7 million last week.

Mr. OTTINGER. It just appears to me that the administration ought to be taking more drastic action—to me the situation seems to be terribly perilous—so you can perform the balancing act to get adequate supplies of heating oil and not have the country close down this winter.

Mr. O'LEARY. Well now, what you have suggested is, first, that we should run more and, second, that we should ration and I would imagine that what you are saying is, we should run more to produce more middle distillate.

Mr. OTTINGER. And gasoline.

Mr. O'LEARY. There is a little bit——

Mr. OTTINGER. The Secretary apparently feels that is possible because he said last week that he is disappointed that the refineries are not turning out more of both products.

Mr. O'LEARY. And I think what we have seen in response to that is the refiners turning out more. They have increased substantially the level of refinery activity. They have gone up from 84 to about 87 percent.

Mr. OTTINGER. Eighty seven percent. Last year at this time they were at 88.9 percent.

Mr. O'LEARY. That is because they had much more available freely available crude last year at this time.

Remember the constraint, the real constraint, in the system, Representative Ottinger, is the availability of crude. We can argue about whether or not they should draw their stocks down, but the real constraint is world availability of crude.

Mr. OTTINGER. If that real availability of crude is the kind of problem you describe then I think we ought to be considering mandatory conservation measures.

Mr. O'LEARY. You recall that we did put——

Mr. OTTINGER. With respect to rationing?

Mr. O'LEARY. We did put those plans before the Congress some time back and the Congress felt that only one of those was worth pursuing and that was the temperature settings for commercial buildings, and we are invoking that next month.

Mr. OTTINGER. I think you would find the mood of Congress has now changed given the type of experiences we have been having.

Mr. O'LEARY. I note that one of the other elements——

Mr. OTTINGER. I voted for the measures.

Mr. O'LEARY. I know you did.

One of the other elements in that plan was Saturday and Sunday closings, and that happily has been achieved voluntarily.

Mr. OTTINGER. I thank the chairman.

Mr. ECKHARDT. Mr. Lent?

Mr. LENT. Thank you, Mr. Chairman.

Thank you, Mr. O'Leary.

In your testimony on page 5 you refer to certain price figures that were furnished to the DOE by the New England Fuel Institute. We were fortunate enough to have John Buckley of the Institute before Chairman Moffett's subcommittee earlier this week in a hearing in which I participated.

In response to my question concerning the distillate stocks in secondary and tertiary storage tanks, Mr. Buckley made the observation that the Department of Energy is for the first time this year including some secondary storage inventory in its heating season target, the target figure of 230 to 240 million barrels that we have been talking about.

Is that correct?

Mr. O'LEARY. We will take into account on the basis of work that EIA is doing for the first time on secondary inventories the state of those inventories in assessing the adequacy of primary stocks, so to that extent that statement is correct.

Mr. LENT. Well, the charge has been heard during some of these hearings that the target of 230 to 240 million barrels may be illusory because what we have is a situation building up whereby refineries are holding back on deliveries to secondary storage facilities in order to build up their primary storage capacity, in order to satisfy the Department of Energy.

Mr. O'LEARY. Mr. Lent, we are aware of those charges and we have discussed the so-called summer fill program with the 13 companies that have participated in it as recently as last year; 10 of those 13 will participate in it again this year. So I really think, although you can fantasize that it will be illusory, that together with the survey which again for the first time is going forward now, will give us a handle on that problem.

Quite obviously you have to take that into consideration. I suspect that in fact secondary stocks are ahead of where they were last year at the moment.

Mr. LENT. These are not the reports that we are getting from the Long Island Oil Heat Institute which claims at least that their secondary tank storage is way down from the previous year and they are flashing the red light to the congressional delegation warning us.

Mr. O'LEARY. Yes, I think until we get these points and right now all you and I can do is speculate, but we will have the material for definitive knowledge in this area within the next few weeks.

Mr. LENT. I would appreciate it if we could hold the record open and that material be submitted for the record.

Mr. ECKHARDT. Without objection, the record will be held open for that purpose.

[The information follows:]

SPECIAL BUSINESS REPORTS

Retail Sales and Inventories of Fuel Oil

Issued October 1979

July 1979

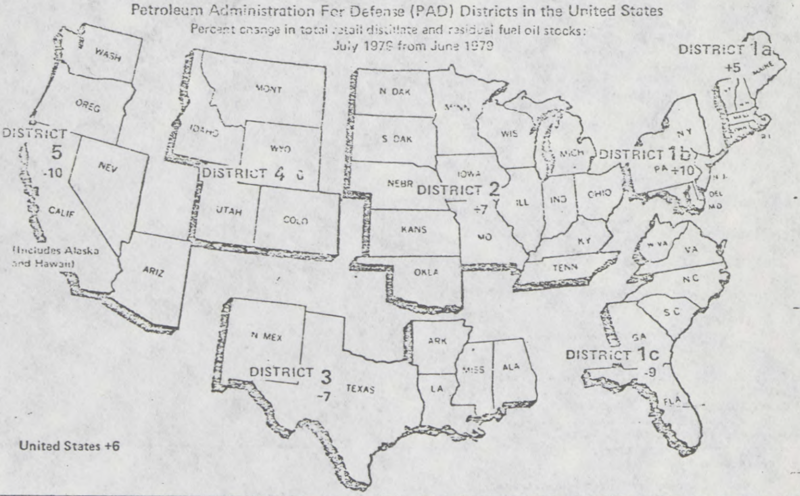
SBR-79-7

Fuel oil stocks – Retail stocks of No. 2 distillate fuel oil in the United States as of July 31, 1979, were estimated to be 5.2 million barrels. This was an increase of about 6 percent (0.3 million barrels) above the June 30, 1979 inventory. End-of-month stocks of other distillate fuels (including kerosene, No. 1, and No. 4 fuel oil) were estimated at 0.7 million barrels and stocks of residual fuel oils, at 0.1 million barrels. Stocks of distillate and residual fuel oils combined totaled 6.0 million barrels, an increase of about 6 percent over similar stocks on hand at the end of June. The largest quantity of stocks was located in PAD District 1b (see map), representing over 50 percent of the national total.

Quantity of fuel oil sold – No. 2 distillate fuel oil sales by retail fuel oil dealers during July 1979 amounted to 8.7 million barrels, a decrease of about 16 percent (1.7 million barrels) from June 1979. July sales of other distillate fuels and residual fuel oils were 0.7 million barrels and 0.5 million barrels respectively. Overall sales of distillate and residual fuel oils were estimated to be 9.9 million barrels, down about 17 percent (2.0 million barrels) from June. Sales were highest in PAD District 1b, with 4.8 million barrels of sales representing 48 percent of the national total for July 1979.

Stock-Sales ratio – The ratio of No. 2 distillate fuel oil stocks held by retail fuel distributors on July 31, 1979, to corresponding fuel oil sales during the month was 0.77 (see table 2).

Petroleum Administration For Defense (PAD) Districts in the United States
Percent change in total retail distillate and residual fuel oil stocks:
July 1979 from June 1979



U.S. Department of Commerce
BUREAU OF THE CENSUS

U.S. Department of Energy
ENERGY INFORMATION ADMINISTRATION

Inquiries concerning this report should be addressed to Tyler R. Sturdevant, Chief, Business Division, Bureau of the Census, Washington, D.C. 20233. Telephone (301) 763-7564.

Table 1. Estimated Monthly Retail Fuel Oil Stocks and Sales for the United States and Petroleum Administration for Defense (PAD) Districts

(Thousands of barrels[1])

Item	Stocks (end of month)			Quantity of fuel oil sold		
	1979		Percent change July 1979 from June 1979	1979		Percent change July 1979 from June 1979
	June[r]	July		June[r]	July	
U.S. total, distillate and residual fuel oil....................................	5,646	5,959	+6	11,905	9,872	-17
Distillate fuel oil, total....................	5,507	5,836	+6	11,191	9,370	-16
No. 2 distillate fuel oil....................	4,900	5,175	+6	10,347	8,651	-16
Other distillate fuel oil....................	607	661	+9	844	719	-15
Residual fuel oil[2]..........................	139	123	-12	714	502	-30
Pad District 1a[3] total, distillate and residual fuel oil....................................	1,177	1,241	+5	2,866	2,141	-25
Distillate fuel oil, total....................	1,175	1,240	+6	2,781	2,083	-25
No. 2 distillate fuel oil..................	1,087	1,144	+5	2,656	2,004	-25
Other distillate fuel oil..................	88	96	+9	125	79	-37
Pad/District 1b[3] total, distillate and residual fuel oil....................................	2,746	3,009	+10	5,795	4,786	-17
Distillate fuel oil, total....................	2,707	2,988	+10	5,310	4,481	-16
No. 2 distillate fuel oil..................	2,565	2,818	+10	4,851	4,082	-16
Other distillate fuel oil..................	142	170	+20	459	399	-13
Pad/District 1c[3] total, distillate and residual fuel oil....................................	644	584	-9	913	887	-3
Distillate fuel oil, total....................	643	583	-9	904	873	-3
No. 2 distillate fuel oil..................	448	402	-10	806	750	-7
Other distillate fuel oil..................	195	181	-7	98	123	-26
Pad/District 2[3] total, distillate and residual fuel oil....................................	927	937	+7	1,676	1,495	-11
Distillate fuel oil, total....................	832	889	+7	1,583	1,412	-11
No. 2 distillate fuel oil..................	668	694	+4	1,448	1,316	-9
Other distillate fuel oil..................	164	195	+19	135	96	-29
Pad/District 3[3] total, distillate and residual fuel oil....................................	31	29	-7	87	92	+6
Distillate fuel oil, total....................	31	29	-7	87	91	+5
No. 2 distillate fuel oil..................	30	28	-7	86	90	+5
Other distillate fuel oil..................	1	1	0	1	1	0
Pad/District 4[3] total, distillate and residual fuel oil....................................	5	5	0	28	26	-7
Distillate fuel oil, total....................	5	5	0	26	26	0
No. 2 distillate fuel oil..................	4	4	0	24	25	+4
Other distillate fuel oil..................	1	1	0	2	1	-50
Pad/District 5[3] total, distillate and residual fuel oil....................................	116	104	-10	540	445	-18
Distillate fuel oil, total....................	114	102	-11	500	404	-19
No. 2 distillate fuel oil..................	98	85	-13	476	384	-19
Other distillate fuel oil..................	16	17	+6	24	20	-17

[r]Revised.

[1]One barrel is equivalent to 42 gallons.
[2]Sampling variability for estimates of residual fuel oil stocks in the United States is nearly 50 percent.
[3]See map on page 1 for States in each Petroleum Administration for Defense (PAD) District.

Table 2. Retail Fuel Oil Stocks and Sales Within Specified Stock-Sales Ratio Ranges for the United States: July 1979

Item	U.S. total[1] (Dealers holding stock)	Stock-Sales Ratio Ranges							
		.001 - .200	.201 - .500	.501 - .700	.701 - 1.000	1.001 - 2.000	2.001 - 3.000	3.001 - 5.000	5.001 - and over
		Thousands of barrels							
End-of-month stocks:									
Total distillate and residual fuel oil......	5,959	204	622	736	470	922	958	1,322	725
Total distillate fuel oil..................	5,836	175	611	763	366	1,082	790	1,342	707
No. 2 distillate fuel oil..........	5,175	186	575	547	445	771	892	1,098	661
Quantity of fuel oil sold:									
Total distillate and residual fuel oil......	7,665	2,358	1,949	1,283	556	665	403	351	100
Total distillate fuel oil..................	7,269	2,105	1,890	1,303	440	762	317	357	95
No. 2 distillate fuel oil..........	6,767	2,227	1,804	934	550	541	343	281	87
Stock-Sales ratio:									
Total distillate and residual fuel oil......	.777								
Total distillate fuel oil..................	.802								
No. 2 distillate fuel oil..........	.765								

[1]Excludes sales of dealers not holding stocks.

Explanatory Material

I. DEFINITION OF TERMS

Retail fuel oil–Coverage in this report is restricted to retail fuel and ice dealers and fuel oil dealers: Standard Industrial Classification (SIC) categories, 5982 and 5983, respectively.

No. 2 distillate fuel oil--Includes No. 2 diesel and No. 2 heating oil.

All other distillate fuel oil- Includes No. 1 and No. 4 fuel oil, No. 1 and No. 4 diesel fuel, kerosene, light gas enrichment oil, etc.

Residual fuel oil -These are the heavier oils that remain after the distillate fuel oil and lighter hydrocarbons are boiled off in refinery operations. They include products known as ASTM grades Nos. 5 and 6 oils, heavy diesel oil, Navy Special Oil, Bunker C oil, and acid sludge and pitch.

Fuel oil sold–Fuel oil sold represents the actual quantity of fuel oil delivered to customers during the report month.

Fuel oil stocks–This refers to end-of-month inventories of fuel oil held at retail establishments in on- and off-premise storage tanks, in delivery trucks, and the fuel oil inventory of auxiliary facilities which are primarily engaged in furnishing supporting services to the retail fuel oil establishments (such as warehouses, garages, etc.). These stocks exclude inventories of fuel oil held in bulk storage tanks which are used primarily for wholesale distributions.

Stock-Sales ratios–The stock-sales ratios shown in this report indicate the relationship of end-of-month inventories to quantity of fuel oil sold during the month. The ratios are derived by dividing the estimates of fuel oil stocks by the corresponding estimates of fuel oil sold. Sales data for firms which do not maintain stocks of fuel oil are excluded in the computation of the stock-sales ratios. In retail trade over 35 percent of the responding firms reported that stocks of fuel oil are not normally carried.

Unit of measure–Participants in this survey are requested to report in gallons, standard U.S. liquid measure. These are converted to barrels, equivalent to 42 U.S. gallons.

II. DESCRIPTION OF THE SAMPLE

The retail fuel oil estimates are derived from a sample consisting of two components:

1. The primary component is a probability sample selected from all retail employers classified in Standard Industrial Classification (SIC) 5982 or 5983 which were in business at the end of 1977. The universe from which this component was selected was the SIC 5982 and 5983 portion of the 1977 Census of Retail Trade.

Those companies in the universe which were selected with certainty in the Bureau of the Census Monthly Retail Trade Survey were included with certainty in the sample and were requested to report for the entire company. For all other retail companies in the universe the sample was selected from the employer identification (EI) numbers assigned in connection with the Federal Insurance Contribution Act (FICA).

Each EI was assigned to a Petroleum Administration for Defense (PAD) District. The PAD District to which the EI was assigned was that District in which the EI had the largest proportion of its total 1977 sales. EI's were then stratified within their major PAD District by 1977 sales. Within each stratum, a random sample of EI's was selected. The sampling weights ranged from 1 to 54.

2. The secondary component is a sample selected from all EI's not belonging to certainty companies and not in business at the end of 1977. These latter cases were selected from the quarterly sample of new businesses used in the Monthly Retail Trade Survey with the sampling weights ranging from 1 to 42. Because of the lag between the time a new firm begins operations and the quarterly sample selection of such firms, published estimates do not include data for recent business births.

For each selected firm in the sample, a report for each PAD District in which the firm has establishments is mailed and tabulated. The published estimates of fuel oil stocks and fuel oil sold are weighted aggregates of these reports. Published estimates do not include data for those firms without employees.

III. RELIABILITY OF DATA

There are two types of errors possible in an estimate based on a sample survey—sampling and nonsampling. Sampling errors occur because observations are made only on a sample, not on the entire population. Nonsampling errors can be attributed to many sources in the collection and processing of data. The accuracy of a survey result is determined by the joint effects of sampling and nonsampling errors.

1. Measures of sampling variability—The particular sample used in this survey is one of a large number of all possible samples of the same size that could have been selected using the same design. Estimates derived from the different samples would differ from each other. The average of these estimates would be equal to the estimate derived from a complete enumeration of the population. This assumes that a complete enumeration has the same nonsampling errors as the sample survey. The sampling error, or standard error of the estimate, is a measure of the variability among the estimates from all possib samples of the same size and design and, thus, is a measure the precision with which an estimate from a particular samp approximates the results of a complete enumeration. Th coefficient of variation (expressed as a percent) is the standa error of the estimate times 100 percent, divided by the valu being estimated. Note that any measures of sampling variabilit such as the standard error or coefficient of variation, are est mates derived from the sample and are also subject to samplir variability. Table A gives the estimates of sampling variabilit (the coefficients of variation in percent) for total fuel oil stock and total quantity of fuel oil sold.

Table A. Estimated Sampling Variability of Retail Fuel Oil Stocks and Sales for the United States and Petroleum Administration for Defense (PAD) Districts

(Coefficients of variation in percent)

Item	U.S. total	PAD[1] Districts						
		1a	1b	1c	2	3	4	5
Total distillate and residual fuel oil stocks:								
July 1979 estimate.....	9	18	16	10	9	3	9	9
Ratio of two consecutive months[2]......	3	6	6	6	3	1	6	6
Total quantity of distillate and residual fuel oil sold:								
July 1979 estimate.....	4	6	6	10	7	8	19	15
Ratio of two consecutive months[2]......	2	6	3	10	3	5	6	4

[1]See map on page 1 for States in each Petroleum Administration for Defense (PAD) District.
[2]Coefficients of variation pertain to the ratio of the July estimate over the June estimate and may not reflect late corrections.

The coefficients of variation presented in table A permit certain confidence statements about the sample estimates. As noted before, the particular sample used in this survey is one of a large number of samples of the same size that could have been selected using the same design. In about 2 out of 3 (67 percent) of these samples, the estimate would differ from a complete enumeration by less than the corresponding percent for that estimate shown in the sampling variability table. In about 19 out of 20 (95 percent) of these samples, the estimates would differ from the results of a complete enumeration by less than twice the percentages shown.

5. Nonsampling errors—As calculated for this report, the coefficient of variation measures certain nonsampling errors but does not measure any systematic biases in the data. Bias is the difference, averaged over all possible samples of the same size and design, between the estimates and the true value being estimated. The accuracy of the tabulated data is determined by the joint effects of the sampling and nonsampling errors.

Nonsampling errors can be attributed to many sources: (1) inability to obtain information about all cases in the sample, (2) response errors, (3) definitional difficulties, (4) differences in the interpretation of questions, (5) mistakes in recording or coding the data obtained, and (6) other errors of collection, response, coverage and estimation for missing data. These nonsampling errors also occur in complete censuses.

Although no direct measurement of the biases due to nonsampling errors has been obtained, precautionary steps were taken in all phases of the collection, processing, and tabulation of the data in an effort to minimize their influence.

A major source of bias in the published estimates is due to imputing data for nonresponse and for data which fail edit. The imputation rates for total fuel oil stocks and total quantity of fuel oil sold are shown in table B.

Table B. Imputation Rates for Nonresponse and Edit Failures

(In percent)

Item	U.S. total	PAD[1] Districts						
		1a	1b	1c	2	3	4	5
Total fuel oil stocks.........	15	6	17	6	24	11	0	29
Total quantity of fuel oil sold...........	11	7	14	7	13	10	0	12

[1]See map below for States in each Petroleum Administration for Defense (PAD) District.

In any new series, data for the first reporting period are usually compared to the second reporting period prior to publication. Because of the interest in this series, the data for the first month are being reporting separately. The data are subject to revision in subsequent reports.

Mr. LENT. Because I am particularly concerned that the primary stock target could be partially, if not totally, unreliable if we have a significant loss in the secondary and tertiary storage buildup because by October 1 those primary stocks are immediately going to be drawn down into secondary and tertiary.

Mr. O'LEARY. You are absolutely right and that is why I have gone to some pains in this and other appearances to say that the 230 to 240 million barrel objective must be looked at in its totality—where are the secondary stocks, where are the imports, where are refinery refunds, what is the weather to be like and I understand you will address this later, and so on.

You can't say that even a 250 million stock buildup would be adequate if indeed that were accomplished at the cost of zero stock position at the secondary level of the industry.

So we are quite cognizant of the point you are making and, as I pointed out now a number of times, have in hand, have in course, the data development that will permit us to know where we are, not simply primary, but with regard to secondary stocks as well.

Mr. LENT. Now, I do have a question on the $5 entitlement program which I understand was designed to encourage imports of distillates from the Caribbean refineries, is that correct?

Mr. O'LEARY. That is correct.

Mr. LENT. On page 12 of your testimony you list increases in imports supposedly attributable to this particular rule. Could you identify for the record from where these increased purchases were secured?

Mr. O'LEARY. I will do my best to, Mr. Lent.

Mr. LENT. I would ask unanimous consent that the record be held open for that purpose.

Mr. ECKHARDT. Without objection, the record will be held open for that purpose.

[The information follows:]

Imports of middle distillate, defined as kerosene, heating oil and diesel, as shown by API statistics are as follows:

Week Ending	Thousands of Barrels	Source
June 29	176	July 6, 1979 API
June 22	190	
June 15	173	
June 8	212	June 8, 1979 API
June 1	116	"
May 25	100	"

The origin of these middle distillate imports will be available, along with the individual importers of record, and actual June volume sometime during the first two weeks of August. We will supply the committee with this additional information.

Mr. LENT. Mr. O'Leary, do you have at the Department of Energy any information which would indicate whether product from the Caribbean refineries is now being sold to European rather than to U.S. markets?

Mr. O'LEARY. We have some inferential statistical evidence to that effect in that our receipts from the Caribbean dropped off rather sharply over the last 6 months, and the assumption is that the entitlements treatment has restored our competitive position but that is about all.

Mr. LENT. It may be that that $5 entitlement is not enough. Do you have any idea how much of a dropoff we have experienced from the Caribbean refineries?

Mr. O'LEARY. As I recall it, and I would like to check these numbers, we were running at something like 200,000 barrels a day and lost about 100,000 barrels a day, and we have now restored most of the 100,000 barrels a day that I think we lost.

Mr. LENT. The last item I would like to touch on is the operation of the Clean Air Act. It is my understanding that, although the heaviest fuel oil—No. 6—is now barred from utility boilers by the local implementation of the Clean Air Act, the President has the authority to relax these rules. Is that correct?

Mr. O'LEARY. On application from the State, yes.

Mr. LENT. On application from a State.

Is the administration examining the possibility, for example, of encouraging that sort of application from States to allow a mixture of No. 2 and No. 6?

Mr. O'LEARY. Yes, sir.

Mr. LENT. In utility boilers?

Mr. O'LEARY. Yes; that is very high on our priority list. We are examining that with States and with EPA right now.

Mr. LENT. Would you have any idea how much home heating oil would be freed up if that sort of switch would be worked out?

Mr. O'LEARY. We have an estimate. Let me wait just a minute and get it from Mr. House. I think that there probably are 150,000 to 175,000 barrels a day that can be obtained from this largely from not the sulfurized crudes that go into it, not out of the desulfurization units, but where relatively high sulfur residue has been blended with a 30 percent admixture of middle distillate to bring it down to point five.

I think in those cases we can directly save middle distillate and, anyway, 150,000, maybe as much as 175,000 barrels a day.

Mr. LENT. So that it does lie within the authority of the President, should the situation——

Mr. O'LEARY. Should the States request.

Mr. LENT. Should the States request, and should the situation so demand.

Mr. O'LEARY. May I put this in perspective? There would, of course, be no question about going into the primary; that is to say, the health levels of air quality. This would take you only down to the primary standard, not below it, and it seems to me at this point in time that that is a reasonable thing for States and for the Federal Government both to do. It seems to me that we now have enough demonstrated insecurity in our supply or the prospects for middle distillate to warrant not going into the health standard, but going into the secondary standards, and that is what we would contemplate.

Mr. LENT. It would seem to me the possibility of adverse health effects resulting from cold homes are far greater and far more immediate than the possible adverse health effects from——

Mr. O'LEARY. I don't think that is the condition of the tradeoff, however. I think, regardless of how this is settled, it is our intention to do whatever is necessary to avoid cold homes. This would rather be additional fuel for the trucking industry to move necessary goods into communities and for factories to keep open so that jobs can be preserved, and I think that would be the real tradeoff, Congressman.

Mr. LENT. I want to thank you for your testimony.

Mr. ECKHARDT. Mr. Kostmayer.

Mr. KOSTMAYER. Thank you, Mr. Chairman. When did the crude oil inventory, Mr. Secretary, begin to come up? Was that in January of this year? I know inventories were low last year.

You say in your testimony, "Now that crude oil stock and import levels are both approaching normal levels * * *."

Mr. O'LEARY. May I refer to notes here?

Mr. KOSTMAYER. Surely.

Mr. O'LEARY. And take just a second.

Mr. KOSTMAYER. It is my understanding that that increase began sometime around January of this year.

Mr. O'LEARY. You can see that we had gotten down into the gray area, which is well into the minimum acceptable level, by January, falling very sharply off from the previous month.

Mr. KOSTMAYER. In other words, prior to January 1979 you were low. Beginning in January——

Mr. O'LEARY. January was the start. We were still in critical position, although building slightly, in February. We came up further in March and came out into the black, the critical area where you are really running so close to the margin that you disrupt refinery operations, and you are really on a runout basis and refinery activities are curtailed. We broke out of that in some point in March or early April and we have been running at a more satisfactory level since.

Here we had a fairly good buildup and we are getting now to the point where crude stocks are in fact quite comfortable.

Mr. KOSTMAYER. You began to come out of this danger area in the latter part of March and early April?

Mr. O'LEARY. Right; yes.

Mr. KOSTMAYER. And it was only a week or so ago that the Secretary requested that refineries increase their yield?

Mr. O'LEARY. No; it was well over a month ago. I think it was more like 6 weeks ago that we began to discuss this with refiners.

Mr. KOSTMAYER. Why did it take so long? Why is there a lag period between the time the oil companies were able to refine more because their crude oil stock supplies were up and the time the Secretary requested the oil companies to do so?

Mr. O'LEARY. There probably wasn't more than a 10-day or 2-week lag between the two events and we don't know these data until a week or two later with any definition, and we have said earlier, don't rely on a week's data, so it wouldn't be until about here, about the beginning of April, that you would know that, and I was saying to the companies and saying before Congress at hearings at about this point, some 2 weeks later that we are now at the point where we think they can increase their runs.

Mr. KOSTMAYER. Do you feel the oil companies have done so?

Mr. O'LEARY. The evidence is that they are now beginning, this last week's evidence is they are beginning, to run up very sharply on refinery utilization.

Mr. KOSTMAYER. Up to about what point?

Mr. O'LEARY. 87 percent.

Mr. KOSTMAYER. Could they bring it up to 91 or 92?

Mr. O'LEARY. I don't think they could.

Mr. KOSTMAYER. Why?

Mr. O'LEARY. They could run probably up to about 89, but that is about as far as they could go and sustain it on the basis of what they have in the system now.

Mr. KOSTMAYER. That 2 percent would amount to how many additional barrels per day?

Mr. O'LEARY. Our additional barrels per day, my associate will tell us in a minute.

Mr. KOSTMAYER. Don't you think it would be a good idea——

Mr. O'LEARY. It would be a good idea except you are refining a lot of gasoline now.

Mr. KOSTMAYER. I am not suggesting you refine it into gasoline.

Mr. O'LEARY. That is what you get out. Fifty percent of it comes as gasoline. It is a total of about 300,000 and the way the refiners are configured about half of that would come out in the form of gasoline.

Your question really is asking, are we imprudent in not doing that for middle distillate, and the answer is we have the stocks there and we have the capacity and if it becomes necessary, we could really shove it through and get middle distillate, and I want to go to the assurances that I made before, that we will make that target.

Mr. KOSTMAYER. I want to ask you about prices in Pennsylvania between April and June of this year. At one particular truck stop in January in Pennsylvania, a major truck stop, gasoline was selling for 81 cents a gallon and diesel for 76 cents a gallon. In June, the same truck stop was selling gasoline at 89 cents a gallon and diesel at $1.23 a gallon. How do you account for an increase of that size? Don't those figures indicate it might be a good idea to return to controls?

Mr. O'LEARY. Are you thinking of the increase on gasoline, which is controlled?

Mr. KOSTMAYER. No, diesel.

Mr. O'LEARY. The diesel fuel number that you have is not representative. That man on the street can charge anything he wants, but by and large he is not; that is not the charge.

Let me tell you why that might be all right. That fellow might have a lot of business. He might be one that is determined that he is going to keep his truck stop open at whatever cost and he might be out buying $1.12 diesel on the spot market. I don't know. He might, on the other hand, be just making out like a bandit.

Mr. KOSTMAYER. How prevalent is it?

Mr. O'LEARY. It is not really prevalent. I think what we are finding is that 80 percent of the diesel or something like that, a substantial amount of it, is being sold at a reasonable price, 80 cents, in that range.

Mr. KOSTMAYER. A return to controls would at least stabilize prices.

Mr. O'LEARY. Well, it would, that's right, and if we are concerned about truckers, they now have passthrough so that they can recoup that in their rate.

Mr. KOSTMAYER. Of course, it is still contributing to inflation and consumers pay for it in the end.

Mr. O'LEARY. Of course it is.

Mr. KOSTMAYER. Somebody is paying.

Mr. O'LEARY. I understand the good side. I know the bad side when you go into price controls and the concomitant set of controls in the system. You really create a monster.

Mr. KOSTMAYER. What do you expect the price of home heating to run in Pennsylvania this winter?

Mr. O'LEARY. I would imagine it will run in the range of 80 cents a barrel.

Mr. KOSTMAYER. A gallon?

Mr. O'LEARY. I am sorry. A gallon.

Mr. KOSTMAYER. I wish it were 80 cents a barrel. Let me ask, it is my understanding we are about 18 percent below where we were a year ago in terms of home heating oil supplies and that we should be increasing our refining capacity by about a third, because we are trying to get 240 million barrels by the first of October.

Mr. O'LEARY. Yes.

Mr. KOSTMAYER. And you said that you think we will get to that?

Mr. O'LEARY. Yes.

Mr. KOSTMAYER. How much of a shortfall or problem would prevent us from getting to it? Another Iran?

Mr. O'Leary. I have said that the only thing that will prevent us from getting to that is another major disruption of supply.

Mr. Kostmayer. A cutback of how many barrels per day?

Mr. O'Leary. If we lose another 2 million barrels a day, 1 million barrels a day to this economy, 2 million on a global scale, it would be very disruptive and I think under those circumstances we couldn't make that objective.

Mr. Kostmayer. A cutback of 2 million barrels a day would be very disruptive?

Mr. O'Leary. Yes.

Mr. Kostmayer. I know our next witness Mr. Barnes—the meteorologist—is here and is going to tell us about the weather. Now, what kind of winter are you predicting?

Mr. O'Leary. We try to develop a capacity to take a winter that is nationally 10 percent worse than normal and that means that you can stand a 20 percent worse than normal area in one part of the country and still, because the weather tends to level nationally here, and still be all right.

Then you get into logistics problems, but not into overall supply problems.

I might point out in that context that even during the natural gas emergency of 1976–77, we didn't have a shortage of fuel oil. We had a lot of fuel oil down in the gulf. Our problem was the rivers were frozen and we couldn't get it into the supply points.

I am told I should correct this to say that we estimate a 5-percent difference, and that is enough to take extremely bad weather in one part of the country leveled with more moderate weather in others.

Mr. Kostmayer. I know you responded to this, but we are 18 percent below where we ought to be. You not only have got to make up that 18 percent, but you have to do it between now and October 1.

Mr. O'Leary. That is right.

Mr. Kostmayer. The 18-percent shortfall, how are you going to fill that?

Mr. O'Leary. We are not 18 percent below where we ought to be. We are 18 percent below where we were a year ago.

Mr. Kostmayer. Where should we be?

Mr. O'Leary. Where we ought to be is maybe where you would like to be at this time of year——

Mr. Kostmayer. Let me put it this way. If we continue at the current rate, with no increase in home heating oil refining at all, where will we be on October 1?

Mr. O'Leary. We will be having stocks of 230 million barrels.

Mr. Kostmayer. Which is how far short?

Mr. O'Leary. Right there. The current rate was last year, last month, last week—I am sorry. Last week we had——

Mr. Kostmayer. This really is contrary——

Mr. O'Leary. Mr. Kostmayer, I discussed this early in the hearing. It is in my testimony.

Mr. Kostmayer. In other words, we don't have to increase our refinery capacity for home heating oil?

Mr. O'Leary. If we continue as well as we did last week, we are going to hit it right on the nose. We added a million barrels a day to the stock last week.

Mr. Kostmayer. It began last week?

Mr. O'Leary. Yes. I pointed out that one week does not a summer make. One sparrow does not a spring make.

Mr. Kostmayer. Where are we going to be a week from today? Will we be refining at the new rate?

Mr. O'Leary. Indeed, you could, and that is why it is really——

Mr. Kostmayer. Isn't that all rather tentative? Don't you think that is cause for some considerable alarm?

Mr. O'Leary. It might alarm you. It doesn't alarm me.

Mr. Kostmayer. I know. That is what I am alarmed about.

Mr. O'Leary. I think, Mr. Kostmayer, if you look back over my history, you have never found me irresponsible, so I put that much to you.

Mr. Kostmayer. You gave us your word. I am not questioning your word. You give your word several times every day before these hearings, but don't you think that the American people have some right to be concerned about this too?

Mr. O'Leary. I think so.

Mr. Kostmayer. What kind of control do you have? You have no control.

Mr. O'Leary. Mr. Kostmayer, we have absolute control over the system.

Mr. Kostmayer. We have absolute control over the situation for home heating oil in this country for next winter?

Mr. O'Leary. As I said earlier—had you been here you would have heard the testimony——

Mr. Kostmayer. I have been here since 10 o'clock and I heard your testimony, and I am alarmed at your casual attitude.

Mr. O'Leary. Then you heard me say, Mr. Kostmayer, and I don't see why I really have to go over and over and over this ground, but I am pleased to again——

Mr. Kostmayer. Because the people are very concerned and neither they nor I am at all satisfied with your answers.

Mr. O'Leary. They are very concerned because here we have statement after statement after statement from this body that they ought to be concerned.

Mr. Kostmayer. We have had statement after statement from the Secretary of Energy which are entirely contradictory and inconsistent. Mr. Schlesinger says one thing one week and another the next. If anyone has been inconsistent, it has been your Department, Mr. O'Leary, that has been so very inconsistent.

Mr. O'Leary. I have heard that.

Mr. Kostmayer. And you have done nothing, frankly, to assure the American people and you have done nothing here this morning to assure this committee that we are going to have adequate home heating oil supplies next winter.

Mr. O'Leary. I have assured and assured and assured, and I don't know what I should do. What should I do? Go out and actually run refineries?

Mr. Kostmayer. That is a possibility, yes.

Mr. O'Leary. Mr. Kostmayer, I disagree with you.

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Mr. KOSTMAYER. One of the things you ought to do, to answer your question specifically, is that you ought to order the oil companies to increase their output, not of gasoline, Mr. O'Leary, but of home heating oil so we know we have enough for next winter.

Now, you say the situation improved just last week. That is not good enough. It is not acceptable. And our job here is to find out if that is too little, too late.

Mr. O'LEARY. It may not be acceptable to you, Mr. Kostmayer, but I have the responsibility—my job is to see that the stocks are right. My responsibility is to report to the President if I fail, and I will tell you that I do not intend to report failure. Those stocks will be built up unless there is a supply interruption. You can say that is not acceptable all you wish.

The fact is, we got through the last two emergency situations without going to the heavy hand, without going to mandating. We did it in ways that minimize adverse impact in the economy. If you would like me to go in and tilt the situation over and make nationwide 3-mile gas lines unnecessary simply because you are a little bit concerned, I am simply not willing to do it and that, Mr. Kostmayer, is the equation that we are working with.

Mr. KOSTMAYER. I want your Department to give to the American people some kind of reasonable assurances aside from your word, which I am sure is good, that we are not going to face serious problems, don't just come up here this morning and say it is all right; or that as of a week ago our refinery capacity has suddenly increased and that we are now suddenly refining enough home heating oil.

Mr. O'LEARY. The President has said that we will have adequate stocks of heating oil and believe me——

Mr. KOSTMAYER. Trust me, he says. I've heard that before.

Mr. O'LEARY. What do you want? You say you want assurances. He has given that.

Mr. KOSTMAYER. I have read your testimony and you say on page 3, "On the basis of the information provided by the 32 refiners." On page 4 you say, "Finally, on the basis of the yield flexibility data collected from the 32 refiners." And you further say at the bottom of that page, "If industry does its part." Then you say on page 5, "Or if refiners do not take the necessary action, we face the very real prospect of severe emergencies."

Your very own memo to the White House. Mr. O'Leary, says:

> If refiners follow historical patterns and maximize gasoline production during the next 3 or 4 months, heating oil stocks will not be built up to the target levels except with a large shortage in distillate supplies for use this summer.

This is your memo. It is that which has changed from just a week ago? And you wonder why we are puzzled? And why the people of this country are confused?

Mr. O'LEARY. I want to again, and I can't go beyond this, I want to assure you, passing on the assurance of the President of the United States, that the first priority of this administration, of the Department of Energy, of the President, in dealing with this emergency situation that we have now is to see to it that there are adequate supplies of heating oil.

I believe, Mr. Kostmayer, that the constant erosion of the President's promise, as is accomplished by the line of questioning in which you are currently engaged, gives an absolutely false signal to the American people.

We will have those supplies. I think it is irresponsible to say that we are not taking those courses of action that will get us those supplies and I want to assure you again——

Mr. KOSTMAYER. Your boss said in Tokyo this morning we wouldn't have gasoline lines in August.

Mr. O'LEARY. If you want to stay with the middle distillate business that I am here before you on, I would be pleased to help you.

Mr. KOSTMAYER. I am not questioning the assurances of the President. I am not questioning the assurance of President Carter.

Mr. O'LEARY. That is fine.

Mr. KOSTMAYER. I am not questioning your word. I think we have the responsibility to raise these questions here. I don't feel that Mr. Schlesinger has answered them satisfactorily, nor do I feel that you have.

Finally, let me ask you, if we do fall below, what contingency plans do you have to insure that the American people will have adequate home heating oil supplies next winter or, if we do not have enough, what are we to do then?

Mr. O'LEARY. We have an organization, Mr. Kostmayer, that has, through two emergencies in the last two winters, demonstrated its capacity for doing precisely that. At that point we go into either formal or informal allocation. We do it through the jobber system and we assure at that point that those supplies that are available will be used for the highest priority uses including, of course, the heating oil.

That is why I think that the raising the apparition, and it is no more than that, raising the apparition that people are going to suffer as a result of shortfall is totally irresponsible.

Mr. KOSTMAYER. I am not suggesting that people are going to freeze. My suspicion is that they are not. What I am saying is, what will it cost? Are we going to have to divert supplies from other segments of our economy to maintain home heating oil suppliers?

Mr. O'LEARY. Right now we are diverting supplies from people, as witness the fact that we are using 9 percent less gasoline than we did last year and 12 percent less than we would like to.

Mr. KOSTMAYER. We can't get it. It is not there.

Mr. O'LEARY. It is because of stupid policies.

Mr. KOSTMAYER. I agree with that.

Mr. O'LEARY. You really ought to be examining those policies because that is the fundamental problem.

Mr. KOSTMAYER. That's what I've been trying to do. You finish by saying, as you said earlier, that traffic is down over the bay bridge by 20 percent. That is not because people are voluntarily conserving, as they should, but because they are not willing to sit in long lines.

Mr. O'LEARY. Of course.

Mr. KOSTMAYER. And because gasoline is not available. It is not because of the conservation. People in California, Mr. O'Leary, as you know, are back driving just like crazy all over again. People haven't learned in California. Traffic is down not because people are conserving voluntarily. Traffic is down because people won't sit in line for 3 or 4 hours and because gasoline is not available.

Thank you, Mr. Chairman.

Mr. ECKHARDT. Mr. Dannemeyer.

Mr. DANNEMEYER. Mr. O'Leary, I have been listening to these questions and your responses and I have come to the conclusion that I suspect that somebody is after your political head and also I suspect that somebody is after the political head of your boss, Mr. Schlesinger, and at times I get the impression that there are some who are interested in the political head of the boss of Mr. Schlesinger.

Then I reflect that these same people are suggesting that the law which you three people are administering was somehow created by you when the truth of the matter is that the law, which you are administering, was created by us, the Congress, and if there is a deficiency in the supply of petroleum product of this country, it is the fault of the law created by the U. S. Congress, not the people in the executive branch who are attempting to administer the law which we have created.

Now, my question is this: Recently an economist of note, a Nobel Prize winner no less, wrote in an article of a national publication this month and he said as follows:

> There is one simple way to end the energy crisis and the gasoline shortage tomorrow, and I mean tomorrow, and not 6 months from now, not six years from now. Eliminate all controls on the prices of crude oil and other petroleum products. The gasoline lines would melt faster than the snows of winter."

What is your response to that suggestion, Mr. O'Leary, aside from the fact that initially you may be inclined to observe that it would put you out of a job?

Mr. O'LEARY. Mr. Dannemeyer, I think that it would and it should. I think that this is absolutely right. The reason that we have lines, the reason that we have this sort of difficulty is because we have decided as a matter of national policy that it is better to temper the people of the working place than to ration them. I have to say that we would not achieve the elimination of those lines at no cost.

My own judgment is, the price of gasoline would have to go to about $3 a gallon before the people would say "I have had enough. I will slow down my driving."

Mr. DANNEMEYER. How much?

Mr. O'LEARY. About $3 a gallon.

Mr. DANNEMEYER. Aren't there really, when you come down to it, only two ways to ration? You are either going to do it by lining up or you are going to do it by price?

Mr. O'LEARY. No, you can do it by rationing, and lining up is a form of rationing.

Mr. DANNEMEYER. I would say it is. Analyzing the American people, it would appear to me that we prefer temperamentally and philosophically to ration by price rather than by standing in a line. Do you share that?

Mr. O'LEARY. We do it on everything else. There is no such thing as the right price for shoes or bread, as the price of the market supplies that. You don't have a monopoly supply and the price tends over time to equal cost. You have freedom of entry.

In this business you have two elements that militate against letting the market run wild. The first element is highly inelastic demand, that is to say, it really takes an enormous price increase to swing me away from gasoline. The second one is a monopoly supplier.

Mr. DANNEMEYER. You talk about the price of gasoline maybe going to $3 a gallon. How much is it in Europe today?

Mr. O'LEARY. $2.50 to $3 a gallon.

Mr. DANNEMEYER. Of that $2.50 to $3 a gallon, what portion is tax?

Mr. O'LEARY. $1 to $1.50.

Mr. DANNEMEYER. So the cost of the product is roughly a dollar and a half?

Mr. O'LEARY. The cost to the consumer?

Mr. DANNEMEYER. No, no; the cost of the product.

Mr. O'LEARY. It is no different essentially, only 10 cents different from the price here, the cost here.

Mr. DANNEMEYER. The cost of the product in Europe exclusive of the tax of the $1.50.

Mr. O'LEARY. Oh, no. The cost of product in Europe is probably 75 cents a barrel; a gallon 75 cents.

Mr. DANNEMEYER. Can we extrapolate what it would cost the consumer driving up and filling up his Fiat with meters at the gas pump $1.50 roughly? What I am trying to do is draw a comparison between what we might anticipate the market price of gasoline to the American consumer in contrast with what the European consumer has to pay for that gasoline per gallon exclusive of the taxes that the government imposed in Europe.

Mr. O'LEARY. I don't think you can do that fairly.

Mr. DANNEMEYER. Let's try it unfairly.

Mr. O'LEARY. In that case, in a year and a half the American consumer and the European consumer will pay the same cost because they will be getting their crude at the same price when decontrol is fully ginned through the economy and the refining costs are probably about the same, distribution cost about the same, and the cost will be something under $1 a gallon, probably 75 cents a gallon.

Mr. DANNEMEYER. I would hope that we have the wisdom and the courage in the Congress to adopt a market system whereby we can let the marketplace determine the availability and supply of our product and send you off to some meritorious job in private industry where you would earn five times what you are getting now, which is what you are worth, and have far less situations of this nature which tend to raise one's blood pressure.

Mr. O'LEARY. I agree with the last part.

Mr. DANNEMEYER. Thank you, Mr. Chairman.

Mr. ECKHARDT. Mr. Drinan.

Mr. DRINAN. Thank you, Mr. Chairman and thank you, Mr. Secretary. You have been very patient all morning. You have been talking since about 8:30 and I appreciate that.

Mr. O'LEARY. I can go now?

Mr. DRINAN. No; I am into going to give absolution right now. I have listened intensely and with great admiration, but I am still apprehensive. While I do not want to nag you anymore, I do want to get into a topic that was not taken up today. It seems to me that there is great promise of the conversion, especially of industrial users and utilities, from oil to natural gas. You mentioned this in your testimony but the only affirmative action that you suggest is really a negative one, that you have repealed certain previous regulations that inhibited or forbade.

With all the uncertainties that are clearly there, it seems to me that the Federal Government should have a massive program, a crash program, with Federal loans and guarantees through FHA and SBA to take the schools of New England off of heating oil and put them on natural gas. Is any contingency plan or any affirmative, very, very affirmative, plan along these lines in the making?

Mr. O'Leary. Congressman Drinan, Bart House, who is our expert on the conversion of households, schools, and hospitals to gas, will tell you about that.

Mr. House. Quite frankly, what we are doing right now is primarily working with stationary sources of the industrial and utility type. We can give you, on a State-by-State basis, those stationary sources within your State that are capable of firing by gas, oil, and we can identify the location of the sources, what its capability to accept the product is. In addition to that we are locating surplus gas within the country and trying to get together the people who can use the gas with the people who have the gas to transport.

The next phase that we will go into will be to try and get the same type of information and the same type of data on those units in the industrial sector that are in the hospital, apartment building area. We are looking at that right now.

Mr. Drinan. I mean D-Day is October 1, and if it is a disaster situation on October 1 and the distillates are not there in reserve do you have a plan right now for a crash program of mandatory conversion of 20 percent or 50 percent of the industrial users, the schools, or the hospitals that could use natural gas?

Mr. House. I have a plan for the industrial users, not the schools or the hospitals.

Mr. Drinan. Why don't you have it? The schools in New England will be closing, the schools in Stow, Mass. will be closing, because they are on heating oil. Why don't you have a plan?

Mr. O'Leary. It is a good idea and we will look into it.

Mr. Drinan. Wonderful. Let me talk about one other thing, about the possibility of actually having the strategic petroleum reserve available. It is my understanding there is some plan for pumps to be installed this summer so that oil can be made available if there is an emergency.

Mr. O'Leary. We are now installing facilities that will permit us to withdraw from strategic reserves at the rate of a million barrels a day on October 1. In the meantime we have a capacity of somewhere between 125,000 and 150,000 barrels a day on the basis of temporary facilities.

Mr. Drinan. I thank you very much.

I yield back the balance of my time.

Mr. Eckhardt. Mr. McCloskey.

Mr. McCloskey. Mr. O'Leary, I know you are faint with hunger, but I will try to ask brief, precise questions and hope you can give brief, precise answers and we will complete early. Before this hearing today I asked you to submit a list of the jawboning actions that you had taken in the last 6 months with respect to heating oil and its competitor, gasoline, in the distillation process. The list that you furnished me does not give any indication that you asked the refiners at any time to refine more gasoline and less distillates.

Mr. O'LEARY. Never did.

Mr. McCLOSKEY. Now, when California had its gas crisis in April it was our understanding that one of the actions the President was ordering was to request the refineries to refine as much gasoline as possible.

Mr. O'LEARY. No; I don't believe that is correct.

Mr. McCLOSKEY. Are you telling me no one told the California congressional delegation that you were asking to refine more gasoline and less distillates in April?

Mr. O'LEARY. Not to my knowledge. We asked the California refiners to increase their runs, but I don't think that there is——

Mr. McCLOSKEY. You did ask the California refiners to increase their runs of gasoline, did you not?

Mr. O'LEARY. No, to increase their runs of crude oil——

Mr. McCLOSKEY. To increase runs of gasoline.

Mr. O'LEARY. Both products, both middle distillates and gasoline.

Mr. McCLOSKEY. Did you make that clear to refiners that they were not to reduce their heating oil-middle distillate output? Is the answer no?

Mr. O'LEARY. I can only speak with regard to my own knowledge.

Mr. McCLOSKEY. Is the answer no or yes?

Mr. O'LEARY. In all the discussions that I have had with refiners I have never asked them to reduce their runs for the purpose of producing more gasoline at the expense of distillates.

Mr. McCLOSKEY. Am I to understand that your request to them to increase the output of gasoline possibly included the reduction of home heating oil or distillates?

Mr. O'LEARY. I don't think they could have. It has been our position at the very outset, Congressman, and repeated time and time again publicly, that we would like to see runs. Incidental to that is the production of more gasoline, but our strategic target is more middle distillate.

Mr. McCLOSKEY. You did ask and you show on your chronological list here as item No. 6 that at the end of March 1979 the Secretary and the Deputy Secretary did urge major oil firms to resist buildup of world spot market prices for crude oil?

Mr. O'LEARY. Rather that has been keeping prices down, but you sacrifice some supply of crude.

Mr. McCLOSKEY. How much?

Mr. O'LEARY. Probably not very much.

Mr. McCLOSKEY. How much?

Mr. O'LEARY. I wish I knew, but I don't kow. We can't know what we might have gotten. My own estimate is that probably it was not more than 100,000 barrels a day for a 2- or 3-week period at best, so a very small amount.

Mr. McCLOSKEY. Did you later suggest to the refiners or the major oil companies that they were free to buy on the spot market at whatever price because of the gasoline shortage here?

Mr. O'LEARY. No, Mr. McCloskey.

Mr. McCloskey. You did not. So they are still under that admonition?

Mr. O'Leary. Mr. McCloskey, let me not tell you when I stopped beating my wife.

Mr. McCloskey. Here is my problem, Mr. O'Leary——

Mr. O'Leary. I am going to have to give some detail on that answer. It is a complicated question and is going to require a complicated answer if you want to hear it.

Mr. McCloskey. Let me say this before you give the answer because of our 5-minute time problem. I took down the specific quote. You said we have absolute control over the system. That was your specific quote.

Mr. O'Leary. In the context of refinery operations, yes, sir.

Mr. McCloskey. So if there is any shortage of distillates next winter, it will be because you have not exercised your control absent——

Mr. O'Leary. With one exception.

Mr. McCloskey. With one exception, the cutoff of supply from Nigeria or something like that. I also wrote down a quote from an earlier meeting with you and I want you to state whether I quote it accurately. "We don't know how to regulate this industry."

Mr. O'Leary. I think we have shown that time and time again.

Mr. McCloskey. In these jawboning efforts which you have used to exercise the control, but short of orders such as special order 9, when you instruct the industry not to buy on the spot market, doesn't that admonition remain in effect until you say to them we release you from our previous instruction? That was the answer you were about to elaborate on.

Mr. O'Leary. No. What we said was during the period of price restoration in Iran we told our companies don't be a leader in driving the spot price up, and then when the Iranians had established their price we indicated to them that if they wished to be on the spot market that was their business, and more recently we have said the gasoline situation is such and the overall crude situation is such there that we are getting a little less than our share probably and we ought to go in and be sure we get our share.

Mr. McCloskey. Did you instruct the companies at the same level as they had been told to stay out of the spot market?

Mr. O'Leary. We have never instructed. We have simply from a——

Mr. McCloskey. Let me say urge.

Mr. O'Leary. Prodding and urging.

Mr. McCloskey. Let me use your word "urge" and I think your earlier words were "persuasion bordering on coercion."

Mr. O'Leary. From time to time I have been involved in persuasion bordering on coercion.

Mr. McCloskey. At what level was that instruction, was that urging, to stay out of the spot market? Was that persuasion bordering on coercion?

Mr. O'Leary. No; it was not.

Mr. McCloskey. Thereafter on the spot market you increased the entitlement benefit to $5. What was the effect of that other than to raise the spot market price $5 per barrel?

Mr. O'LEARY. The effect of that was to raise for a few days the spot market price by $5. It then came down. The net effect has been that thus far we have been increasing our imports at a current level of about 90,000 barrels a day of much needed middle distillate, so it has been very advantageous.

Mr. McCLOSKEY. Do you feel the 90,000 import level is due to the $5 entitlement?

Mr. O'LEARY. Yes; I think that a substantial amount of that increase which is now about 90,000 barrels daily is attributable to the $5.

Mr. McCLOSKEY. I have a document in front of me that was furnished to Chairman Eckhardt's subcommittee that is entitled "Draft of the Middle Distillate Situation, June 6, 1979." There is a note at the top, "To the White House on the 6th of June, encouraged by Secretary Schlesinger." Are you familiar with that document?

Mr. O'LEARY. I have read that document some time ago.

Mr. McCLOSKEY. The document on page 4 says as follows: "Five key assumptions underly the 230 million barrel projection:" The first is, and I quote, "crude runs of 14.6 million barrels per day." On the memo that you gave us this morning the same statement is made; five key assumptions form the basis for the 230 million barrel projection. The first item, crude runs at 14.9 million barrels per day. Can you tell me why the difference between June 6 and June 28?

Mr. O'LEARY. Yes; the difference is explained by the difference in date between June 6 and June 28. Tomorrow morning it will be slightly over that, and by the 15th of July it will be about 15.1.

Mr. McCLOSKEY. So it is 14.9 as of today and what this week have been the crude runs per day?

Mr. O'LEARY. Last week it was 14.7.

Mr. McCLOSKEY. 14.7. If I recall your testimony the 3 weeks prior to that it was 14.2 to 14.4?

Mr. O'LEARY. That is correct.

Mr. McCLOSKEY. Considerably less than the assumption that you were making. That would give some room for optimism, wouldn't it?

Mr. O'LEARY. When you get into the assumption business you do a linear analysis, and that is a result of linear analysis. We can accomplish that in two ways, by keeping runs high or by tilting dramatically over toward middle distillate or by importing a lot of middle distillate, and consequently you cannot take any one of these elements without taking into account all the others. You don't have to meet all five of these things. You have to meet them in sufficiently high combination so that they permit the attainment of the goal.

Mr. McCLOSKEY. Now, in response you said in this memorandum to the President that the distillate stocks could be increased to 240 million barrels by reducing consumption this summer by 8,000 barrels a day or about 3 percent. Has the Government taken any action by Executive order to cut the Government's own consumption of distillates by the 3 percent? I note the Blue Angels are scheduled to fly all over the United States this summer.

Mr. O'LEARY. Jet fuel, military jet fuel, is not part of it, but the rest of the Government is under a minimum 10-percent-saving order.

Mr. McCLOSKEY. I want to have you look at the question as to whether military jet fuel for things like the Blue Angels isn't the sort of thing where the Government might set an example to the country in asking for restraint that might be considered.

Mr. O'LEARY. My understanding is that Dr. Schlesinger has talked to Secretary Brown and asked him this to cut back on military uses, so that very question is being examined.

Mr. McCLOSKEY. Let me take another executive branch option you might have. Under the Walsh-Healey Act the defense contractors, 250,000 of them in this country, are required to work 40 hours a week unless the President suspends Walsh-Healey if he finds the national interest requires it. In my district we had the contractors, Silicone Valley, write to the President and to Mr. Schlesinger and they said, "We request that you exercise your discretion under Walsh-Healey to allow us to work a 4-day week at 10 hours rather than a 5-day workweek which will cut commuting from 5 days to 4." We don't even have a response from the President or the Secretary on that point. What is the decision on the Walsh-Healey Act extension?

Mr. O'LEARY. If I could have a copy of the letter I will get you a decision rapidly.

Mr. McCLOSKEY. The letter is dated May 23, 1979.

Mr. O'LEARY. I don't have a copy but if you can get one to me I would be more than pleased to get you a response to that very soon.

Mr. McCLOSKEY. I would ask, Mr. O'Leary, if you could submit for the record, and the record could be held open for this purpose, a list of the options that the executive branch of Government has to order the executive branch to reduce the consumption of either distillates or any competing fuel which might reduce the consumption of distillates or increase the supply of distillates. According to your statement here by reducing the consumption 3 percent you could meet the 240 million barrel level by October 1.

Mr. O'LEARY. I will be pleased to supply that to you. I will point out the Government is under, not defense, but otherwise Government, order from the President in March of this year to reduce consumption by 10 percent. In addition to that, we have gone to the 4-day or going to the 4-day week, as I understand it, for the entire Federal Establishment in Denver.

Mr. McCLOSKEY. That is the problem, you go to the 4-day week but don't even respond to the voluntary request of industry to cut its commuting. It is a little bizarre.

Mr. O'LEARY. Let me tell you that my own feeling is that this is not necessarily a saving right off the bat. I suspect what is going to happen is that we will find that the people who are the beneficiaries of the 4-day week in Denver will have in effect a 3-day weekend every weekend.

Mr. McCLOSKEY. You think they will drive out, go beyond, and use the gas?

Mr. O'LEARY. I wouldn't be surprised that there is not more driving rather than less.

Mr. McCloskey. That may be, but it is that kind of attitude that causes the people back home when asked to conserve to oppose a means of conserving, when they run into a Washington response, well, you aren't going to conserve, anyway. And you're not doing anything to conserve on your part.

Mr. O'Leary. I just offered that as a personal observation. I will get you an answer to your letter.

Mr. McCloskey. I would love it if you would honor Mr. Moffett's invitation to go to Connecticut and stand up in front of a couple thousand of his constituents. If I relayed that answer back to several thousand of my people who are sitting in gas lines looking up at the Blue Angels on August 10, I think you ought to see their response.

Mr. O'Leary. Have gas lines come back to your sunny State, then?

Mr. McCloskey. Not yet, but if they do come back on August 10 and if the Blue Angels schedule goes forward as the invitation that I received yesterday indicated, if those gas lines are looking up at the Blue Angels, there is going to be all hell to pay.

Mr. O'Leary. This is a point that is, of course, a matter before the Secretary of Defense, not, happily, the Secretary of Energy.

Mr. McCloskey. I wonder why the Secretary of Energy excluded that from the——

Mr. Moffett. Will the gentleman yield?

Mr. McCloskey. Gladly.

Mr. Moffett. As the ranking minority member on our subcommittee, you know we held some confidential hearings on Federal energy conservation efforts and found that the Department of Defense uses 86 percent of the energy within the Federal Government, and that when these conscientious, and I mean that, seemingly conscientious people at the Department of Energy, charged by Executive order and Federal legislation with establishing conservation in every agency, went to the Defense Department and tried to be tough, they were rebuffed not only by the Defense Department, but by their superiors at the Department of Energy, and the record is very clear on that.

So with all due respect to Mr. O'Leary, they do have some control and they should utilize it. I agree with the gentleman.

Mr. McCloskey. I think part of the reason for these hearings, Mr. O'Leary, at which you undergo this painful process of angry questions by people is to strengthen your hand with agencies such as Defense in the disputes that must be resolved by the White House when you would like one thing and Labor probably would like to keep the 5-day week and Defense would like to be immune. In those battles the thing we would like to stimulate is a White House decision coming down on the side of the energy question when at all possible. Reserve training, for example. Why can't it be infantry training this year instead of mobile training? That kind of decision we think you ought to fight for, and by making it tough on you I hope we stimulate your courage in those interagency battles with those fellows from Georgia.

Mr. O'Leary. Let me tell you, Mr. McCloskey, one of the sad points in this whole business is the Federal Government's energy management practices. One of the things that we found, for example, is we are able to single out high-return investment in our own facilities and, you know, to give you an idea, we have several sections under roof, not just acres under roof, but several sections under roof. We have a lot of facilities and they require a lot of heat. We found a lot of ways in which you could save money. They require investments. Congress has been not uniformly delighted to provide us with the money.

Mr. McCloskey. Let me ask you a specific question because a man, a friend from my district who came to this town to take over as the head of the Office of Energy Conservation, left in some dismay I believe because he felt the White House and the Secretary were not backing up conservation by the Federal Government as a priority issue. Now, is that a fair approximation of how morale is in the Office of Conservation in your Department?

Mr. O'Leary. I think that there is a fair amount of support within the administration. We find a great deal of hostility to appropriating money, however, on the part of the Congress in this area.

Mr. McCloskey. We are the enemy of conservation, but the——

Mr. O'Leary. No; I just offer you that as a——

Mr. McCloskey. Glad to have that observation, but what I asked you was this question: Whether or not within the Department of Energy the morale of the Office of Conservation isn't fairly low because they don't feel they are backed up on the conservation side of this equation.

Mr. O'Leary. No; I really don't think so. You have to talk to those people. I think if there is a morale problem it comes from a good deal more complicated reasons than that.

Mr. McCloskey. What about your morale when you go and try to battle with Defense and Defense wins rather than you win on trying to cut Defense's conservation program?

Mr. O'Leary. I have gotten to the point where those sorts of little revolts don't affect my morale.

Mr. McCloskey. Little? That is 85 percent of the Federal Government's energy consumption. Your whole program is down the drain if Defense is immune.

Mr. O'Leary. Defense is not immune. It is the military aspect of Defense. That is President Carter's decision.

Mr. McCloskey. Thank you.

Mr. O'Leary. Thank you.

Mr. Eckhardt. Mr. Sharp.

Mr. Sharp. Thank you, Mr. Chairman.

Mr. O'Leary, let me ask you a couple of questions I think you have not been asked. I am quite sure you probably covered the waterfront up here. First of all, when we get into the heart of the season in late August and September what do you anticipate happening in terms of diesel availability for the farming situation and will it be necessary or will you be prepared to reinstitute, if necessary, special rule 9?

Mr. O'Leary. Congressman Sharp, we are prepared to reimpose controls, but I think we will not permit the reimposition of precisely the sort of controls that we had under special rule 9. It was widely abused and I don't think we want to run that risk again.

Mr. SHARP. In your planning what is your expectation of the situation?

Mr. O'LEARY. My expectation is that we will probably have a tight situation at that point and when that occurs we will take, as we did this spring, the necessary action. It may be, however, that we will be sufficiently comfortable by that time—there is a small possibility of this—that we won't have to do that. Mr. House, who is responsible for seeing to it that we do not have thrashers idle in the field, however, is prepared to do what is necessary to assure that we do not have idle thrashers in the field.

Mr. SHARP. It is my understanding that you take in the harvest season about two-thirds as much as it does for planting.

Mr. O'LEARY. Yes.

Mr. SHARP. Is it that the intensity of that may not be as great?

Mr. O'LEARY. Well, this time we had a very intense planting season and of course harvest does occur over a relatively—we are always worried about this as it hits a part of the country. It does occur in a very, very crowded season with the people working really 20, 24 hours a day in the field during that 2-week interval, so it does present at best a supply problem and I think this year it will be harrowing, but we will do it.

Mr. SHARP. Rule 9 obviously was instituted very rapidly and had many deficiencies probably as a result of the speed with which you had to act. Is in fact planning underway now so that something will be available in terms of a mechanical system to use so that we are not caught with an unenforcible mechanical system when we reach that point?

Mr. O'LEARY. Yes, we do have planning underway, but let me tell you the difficulty of this kind of a business. We must depend, because we can't predict where the shortage will occur, on a very, very rapid certification system, and the abuse of the rule 9 was through certification. I suspect that what we had was two kinds of abuse, first of all of people, farmers, certifying well beyond their immediate needs against the harvest and filling tanks against the harvest because they were insecure, and no wonder, with regard to the prospect for the winter. We hear from high places so many assurances of disaster that it is no wonder that they are insecure.

The second thing that we found is that there was certification with obviously leakage. I referred recently, a little while ago, to the $1.23 price at a truck stop. It is not at all unlikely that the supply for that truck stop came from his certifications in the agricultural side and actual syphonage to meet that market at a black market price. So those are the sorts of things that you encounter when you don't like price controls with allocation controls.

Mr. SHARP. Let me ask you now another question if I heard correctly. There is to be an allocation putting it out of the rural areas and into the urban areas of gasoline. Will you tell me what is about to happen?

Mr. O'LEARY. I will tell you what may happen. We have today or will today put out a clarifying order on one of the elements of our rules that deals with the 5 percent corporate flexibility under our allocation plan. We have provided in our regulations flexibility for the corporation to meet hardship situations up to 5 percent, that is to say he can do it as his own set-aside. Companies have not utilized that. I understand why. They prefer not to act in any arbitrary sense.

We have now put out a clarification saying yes, you can use it, and urge Governors to work in consultation with the companies in the utilization of that authority. Now, in a local sense, that might mean that in a State where the rural areas are long on gasoline, or quite comfortable, it would mean moving gasoline supplies in to meet a metropolitan area shortage. I think that that is perfectly appropriate.

I might point out also that I think that that sort of fine tuning is better done at the State than at the Federal level.

Mr. SHARP. If I understand correctly it is not that you are issuing any order of movement of gasoline. What you are doing is allowing greater flexibility for the supplier?

Mr. O'LEARY. Not even that. We are simply pointing out that that flexibility does exist.

Mr. SHARP. Does exist and he is aware of that. I see.

Mr. O'LEARY. Yes.

Mr. SHARP. But then the Governor, through his set-aside, or through the corporate 5 percent set-aside the Governor might wish in consultation to have the corporation make that decision. I assume, though, the Governor has no authority to direct the corporate set-aside. If he so thought, he would discuss it?

Mr. O'LEARY. He would have to work with the company. The company would have to agree, but I am quite sure if the Governor said do it the company would be willing to do it. I talked to three companies yesterday about that in the consultations that I had with the majors and I detected no unwillingness. Technical problems, yes, but no unwillingness.

Mr. SHARP. When you talk about corporate set-asides, however, are you just talking about moving, however, from one State to another?

Mr. O'LEARY. No, I made it quite clear that this is an intramural activity.

Mr. SHARP. Within the State, if you are the prime supplier in a State you cannot yank out 5 percent from one State and shift it over to another State?

Mr. O'LEARY. That is correct.

Mr. SHARP. Obviously my State has a stake in that.

Let me ask you a third question with respect to the goals that we have, and I suspect an apparent inconsistency exists, and I am trying to find if it is a real inconsistency. I understand your testimony and the desire of the Government, and I think most of us, is that at least for the immediate future we should be trying to import more crude oil and more distillates in order to meet our emergency needs this summer, and this winter.

The President, of course, and I think the country, should be committed to trying over the long haul to reduce our imports. To what degree does our immediate situation conflict with the commitment we are building to cut imports?

Mr. O'LEARY. Well, it is obviously in fundamental conflict, and that is really the difference between the freedom of maneuver of the moment and over a period of years. Over the period of the next 5 years we can institute basic changes in this economy that can, to a degree, reduce our import dependence. The congressional action last year on NEP is a step in that direction, but in the short run, when you are faced with the exigencies that we find now, we ought to do everything in our power to see to it that this country gets its fair share of the world's oil and of its products.

Mr. SHARP. And I would expect that even though we are clearly committed, and I think our Government should be committed, to reducing our imports, we do not anticipate any kind of action in the next few months to deliberately prevent oil from coming into this country?

Mr. O'LEARY. I should be very much surprised if that were the case. I do not think that we would have the tolerance to voluntarily reduce imports until such time had elapsed to permit us to put in place those fundamental changes that would permit us to reduce our dependence.

Mr. SHARP. Let me ask you a fourth question. With respect to your speculative price of $3 a gallon before most of us would really alter our behavior with the automobile, I am not certain whether that is the price you suggest that would be necessary to clear this mess up, or whether that was just the ultimate movement. I mean if we yanked off controls tomorrow, Monday morning we said let's try an experiment here, let's throw out price controls. Let's throw out allocation controls, what market price would you and I and everybody else who have been waiting in gas lines probably have to pay?

Mr. O'LEARY. You are talking about the short run effect? I think timidity on the part of the system would be of the sort that a child early in the spring exercises when he first goes down to the lake and puts a finger, a toe in the water. A toe goes in, a dime. Another toe goes in, another dime, and then bravery, the knee, 50 cents, and so on, until finally we had the total immersion and they said, marvelous, marvelous, marvelous, $3. I think it could go up over a period of 2 or 3 months, if there were absolute assurance that there would not be the reimposition of controls.

Now you understand that a lot of the present price for middle distillate, the reason it is below the world price, is because of fear, and well justified fear, because I have told them, the Congress has told them, the Secretary has told them, if you abuse this we will slap you back under controls, and that has kept the price from being—there wouldn't be any need to allocate to farmers diesel.

The price there probably would clear at something under $2 because there is much more responsiveness to it, but quite clearly as long as price through either surrogate or real price controls, and I think we have to say that for middle distillate there are surrogate price controls for gasoline real price controls, is below market clearing, then you have in periods of shortage an allocation problem, a rationing problem, if you will.

As one pointed out earlier, Congressman Dannemeyer pointed out earlier there are two ways to clear a market, either through rationing as we are doing now or through price adjustments.

Mr. SHARP. There was a recent editorial in the Wall Street Journal which I think suggested that it would be a dollar or $1.30, and others have written about this of a clearing price, if we would just yank the controls off, speaking of gasoline now, and there are clearly people paying that price at some places at the moment. It is your contention, however, that in fact the clearing price would likely move up fairly rapidly?

Mr. O'LEARY. Yes.

Mr. SHARP. Above that?

Mr. O'LEARY. What I know about this suggests this: that to get a bit technical with you, the elasticity of the demand for gasoline, let's say gasoline today is $1, it isn't quite but let's say that that is good enough, and we have got a 10 percent shortfall. The elasticity of demand is reputed to be something under 0.1, and that would indicate that in order to get 10 percent out of it you have to up 100 percent in price. That alone would yield you a $2 price.

Now maybe that is it. My own view is the price elasticity has been, over time, less than 0.1. We will change our habits, we will change the car we buy. The next car will permit us to go on down, and I believe that that is what the economists are thinking of when they give us the 0.1 number. I think the gasoline price trajectory would, everything else being equal, up into the $3 range and back into the $2 range as we change vehicles, but as you know, car stocks turn over about every decade and it would be 4 or 5 years before you get significant relief in demand from getting smaller more conservative vehicles into it.

So my own feeling would be if you tomorrow morning, kept everything the same, and went into a free market, it would take something approaching $3 to clear, and probably over time that would go down to $2, if we kept a 20-percent shortage. Now what you hope is that this, as other shortages, will be shortlived and will return to some better fit between market supply and market demand in the future, but I have to tell you that I see shortages a long time to come, and consequently if that is the situation, would look at gasoline prices as being very high indeed, should we go to control and promise that we would never, never—well, hardly ever—put the controls back on.

Mr. MOFFETT. Would the gentleman yield?

Mr. SHARP. Yes.

Mr. MOFFETT. The gentleman has a very important line of questioning with regard to import increases. The President is in Tokyo saying, as I understand it, we need an international agreement to limit imports, and I applaud it. I think the gentleman from Indiana applauds some strong action with regard to the cartel, but how does this action square with the need that we all seem to agree is there to dramatically increase imports of distillate in order to make the target? Are they in conflict?

Mr. O'LEARY. No, I really don't think so. My understanding—and it is based, of course, upon the press reports—is that the President's statement and the agreement at the summit ran to a 1985 objective, and as I have indicated, there is a difference in freedom of maneuver between what you have to do to get by tomorrow morning, and what you can do if you can plan ahead and put some fundamental reforms in place, so I don't really think that they are in fundamental conflict, Congressman Moffett.

Mr. SHARP. It is a matter of the time.

Mr. O'LEARY. Yes. Given 5 or 10 years you can do anything to the system, but given a year or two, you are really captive to the present.

Mr. SHARP. Let me ask you, with the decontrol program of crude oil, we still will have gasoline price control, product controls until 1981, is that correct, unless we have an energy action prior to that time?

Mr. O'LEARY. No, that is not correct, and perhaps Michelle Corash from the General Counsel's Office—you are now into a legal realm, and I would like her to respond to this.

Ms. CORASH. I assume, Congressman Sharp, when you ask about an energy action you are referring, you are using that term in the way it is used in the statute. In order to decontrol gasoline prices, the position of the Department has been that as of the time that the President's authority became discretionary, that that authority could be taken, would be taken in all likelihood pursuant to a rulemaking procedure as required by the Administrative Procedure Act, but would not be required by the statute to be submitted to Congress for a one-House veto.

Mr. SHARP. Let me ask you this. Is there a distinction to be made between totally removing the control and simply changing the control?

Ms. CORASH. Not with respect to the need for an energy action.

Mr. SHARP. I see, so you assume that at this point you could issue a rule which would totally decontrol or change the controls. I understand there are some proposals out to change the regulatory system on gasoline. Is that correct? Can you give me an indication as to the timetable?

Ms. CORASH. That is correct, there is a proposed rule, there was a proposed rule issued some 2 weeks ago which proposed to change the pricing scheme at the retail level on gasolines. There were four alternatives identified in that proposal, and one was singled out as the one which is receiving the most serious consideration at the moment, and we expect that rulemaking to be finalized within the next 2 or 3 weeks.

Mr. SHARP. Two or three weeks. So in July at some point you would anticipate we will see a change in the price control system on gasoline?

Ms. CORASH. If the record in that proceeding supports it, and certainly the early indications are that that will be the case. I would expect that by the end of July, no later than the end of July, there would be a finalization of that rule.

Mr. SHARP. And what appears to be at this point the preferred rule? What are the basic elements of that, can you tell me?

Ms. CORASH. You say preferred rule. We have received comments on the present regulatory scheme ever since it went into existence. Recently the principal recommendation which has been made along the lines of changing the regulatory scheme in a way which would make it easier, both for retailers and for the consuming public to understand, and therefore more enforceable, more easy to enforce, is some system which would basically adopt a markup over the product cost, a markup which would reflect the nonproduct cost, profit and rent.

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Mr. SHARP. In other words, a uniform markup; is that the theory?

Ms. CORASH. That is correct. Obviously there would be some variation in the price of the product, but the markup allowed would probably be uniform, and it would either be expressed in terms of absolute cents or as a percentage of product cost.

Mr. SHARP. I see, because that contrasts with the present system, whereby the markup is based upon their previous experience of that particular supplier.

Ms. CORASH. That is correct, and their previous costs and previous profit margins.

Mr. SHARP. Thank you very much.

Mr. ECKHARDT. If there is no objection, the Chair would at this time like to hold the record open or place in the record some instruments that bear on some of the questions asked by Mr. McCloskey and Mr. Lent. They have to do with the rule propounded by the Agency of May 24 in docket No. ERAR7927 respecting middle distillates, in which it was stated that—

> We are therefore adopting on an emergency basis amendments to the entitlements program which will provide a $5 entitlement benefit to imports of middle distillates for the months of May 1979 through August 1979. We believe this action will facilitate and encourage the increased importation of middle distillates from refineries located in the Caribbean and in the Western Hemisphere.

In the preparation for this hearing, the Subcommittee on Oversight and Investigations has directed letters to each of the big Caribbean refineries with exporting capacity, Exxon at Aruba, Texaco at Trinidad, Shell at Curacao, and the Borco refinery, which I think is a subsidiary or related with Chevron in the Bahamas.

We have responses from all but Texaco to questions of the following nature: "Will the $5 entitlement rule influence or cause Exxon to import any additional quantities (beyond what has previously been programed, if any) of No. 2 fuel oil into the United States between now and August 31, 1979? Please explain."

Exxon's response: "The $5 entitlement will allow Exxon to be more competitive in the world spot market. However, due to the uncertainty of spot supplies, it is difficult to assess the likelihood of making these purchases. With respect to No. 2 fuel oil supplies to the United States from our Aruba operations, Exxon does not anticipate that the presence or absence of the $5 entitlement rule will change the amount imported between now and August 31, 1979."

Chevron—and I would offer this in the record at this point—Chevron answers: Chevron Oil Bahamas does not have uncommitted supplies to permit an increase in No. 2 fuel oil shipments to the United States in response to entitlement change since all excess middle distillates have been committed to either domestic affiliates before the announcement of the $5 entitlement benefit.

Scallop Petroleum Co., a marketing arm of Shell, says, "The $5 entitlement does not close the gap between contract and spot prices so that imports are not currently contemplated."

Without objection, the record will be left open for the reply of Texaco, and the letters in their entirety will be placed in the record at this point without objection.

[The information follows:]

EXXON INTERNATIONAL COMPANY

1251 AVENUE OF THE AMERICAS, NEW YORK, N.Y. 10020

Supply and Transportation Department
G. H. THOMSON - Operations Manager

June 28, 1979

The Honorable Bob Eckhardt
Chairman, Subcommittee on
Oversight and Investigations
Congress of the United States
House of Representatives
Washington, D.C. 20515

Dear Congressman Eckhardt:

Attached to this letter are responses to the five questions posed in your request of June 21, 1979 relating to the potential impact of the $5 entitlement benefit on imports of No. 2 Fuel Oil to the United States from Exxon's Aruba refinery in the Netherlands Antilles. While the questions relate quite specifically to the $5 distillate entitlement, we see the issue in somewhat broader perspective. Exxon has consistently supported an entitlement system for all products which would be equal to the existing crude run entitlement. This is necessary to distribute the benefits of price-controlled crudes to all U.S. consumers.

We trust that these responses, as well as previous discussions with your staff on the $5 entitlement benefit, will prove helpful.

Very truly yours,

G.H. Thomson

Q.1. INDICATE THE MARKETS (I.E., EUROPE, U.S., LATIN AMERICA) WHERE NO.2 FUEL OIL PRODUCED AT THE ARUBA REFINERY HAS BEEN SOLD OR DISTRIBUTED BY EXXON SINCE JANUARY 1, 1979. IS THE NO.2 FUEL OIL BEING SOLD ON THE SPOT MARKET OR PURSUANT TO LONG-TERM SUPPLY CONTRACTS?

Most products from our Aruba refinery are shipped to the United States. Occasionally, unplanned shipments to other locations, primarily Europe, are made to relieve short term operating problems. Over the past two and one half years, such shipments to Europe have represented less than 1% of the products delivered to the United States from Aruba.

Specifically with respect to No.2 fuel oil, since January 1, 1979, ninety percent of the No.2 fuel oil produced at Exxon's Aruba refinery has been delivered to the United States. This includes shipments to our U.S. affiliate as well as oil delivered under a term agreement to TEXACO, which we believe was moved to the United States. The remaining ten percent reflects two cargoes which were sent to Europe in January and February.

No.2 fuel oil from Aruba sold to our U.S. affiliate reflects a traditional supply relationship between our affiliates in Aruba and the U.S. Exxon has not sold No.2 heating oil from Aruba on the spot market in 1979.

Q.2. SINCE MAY 24, 1979, WHAT VOLUMES, IF ANY, OF NO.2 FUEL OIL HAVE BEEN IMPORTED INTO THE UNITED STATES FROM THE ARUBA REFINERY IN RESPONSE TO DOE's $5 ENTITLEMENT RULE?

Since May 24, 1979, all No.2 fuel oil from our Aruba refinery has been imported into the United States. This represents previously programmed moves and is consistent with historical patterns for Exxon.

Q.3. AS A RESULT OF THE $5 ENTITLEMENT RULE, DOES EXXON HAVE ANY PLANS TO BUY CRUDE OIL ON THE WORLD SPOT MARKET IN ORDER TO PRODUCE ADDITIONAL NO.2 FUEL OIL AT THE ARUBA REFINERY FOR ULTIMATE IMPORT INTO THE UNITED STATES? PLEASE EXPLAIN.

Even with the $5 entitlement rule, Exxon does not find it economically attractive to purchase crude oil at the spot market, refine it at Aruba, and import the resulting No.2 fuel oil to the United States.

Q.4. WILL THE $5 ENTITLEMENT RULE INFLUENCE OR CAUSE EXXON TO IMPORT ANY ADDITIONAL QUANTITIES (BEYOND WHAT HAS PREVIOUSLY BEEN PROGRAMED, IF ANY) OF NO.2 FUEL OIL INTO THE UNITED STATES BETWEEN NOW AND AUGUST 31, 1979? PLEASE EXPLAIN.

The $5 entitlement will allow Exxon to be more competitive in the world spot market. However, due to the uncertainty of spot supplies, it is difficult to assess the likelihood of making these purchases.

With respect to No.2 fuel oil supplies to the United States from our Aruba operations, Exxon does not anticipate that the presence or absence of the $5 entitlement rule will change the amount imported between now and August 31, 1979.

Q.5. WHAT EFFECT, IF ANY, DO YOU BELIEVE THE $5 ENTITLEMENT RULE HAS HAD ON THE WORLD SPOT PRICE OF NO.2 FUEL OIL?

At the time of the announcement of the $5 entitlement rule there was a sharp increase in the worldwide spot price of No.2 fuel oil. However, other factors were also affecting the market at that time and since then, the spot price in Europe has declined.while Caribbean prices have held firm. Consequently, it is difficult to assess the impact of the $5 entitlement rule on the spot price for No.2 fuel oil except to say that it undoubtedly placed upward, albeit temporary, pressure on the market.

ALS/og
6/28/79

Chevron

Standard Oil Company of California
225 Bush Street, San Francisco, CA 94104

D. N. Maytum
Secretary

June 28, 1979

The Honorable Bob Eckhardt
Subcommittee on Oversight
and Investigations
Committee on Interstate
and Foreign Commerce
Congress of the United States
House of Representatives
Washington, D.C. 20615

Dear Mr. Eckhardt:

The following responds to your letter of June 21, 1979 to Mr. D. W. Callahan regarding Standard Oil Company of California's distribution of No. 2 fuel oil from Bahamas Oil Refining Company.

By way of background, it should be understood that Chevron Oil Bahamas (COB, a Socal subsidiary) is presently a 35% partner in the Borco Refinery, and comments herein pertain only to COB's operations. It should also be noted that, due to world-wide oil shortages, Socal's customers and subsidiaries are being allocated on a uniform basis less crude oil than they require. As a result, Socal subsidiaries have necessarily allocated product supplies to their customers worldwide, including the United States, throughout most of 1979.

Replying to your questions in the order presented:

1. In 1979 to date, No. 2 fuel oil from COB's share of the Borco refinery has been supplied to local customers to meet demand in the Bahamas, as well as shipped to the United States, Europe, Latin America, and the South Pacific. With the exception of two small cargoes early in the year, no COB sales were made on the spot market. It is, however, possible that some of the Borco product might have been resold as spot cargo sales by COB's customers.

2. From May 24, 1979 to date, 448,000 barrels of No. 2 fuel oil have been imported into the United States from COB's Borco refinery production. However, none of this can be attributed specifically to the $5 entitlement benefit.

3. No. Socal's policy is to buy crude oil for its basic needs under long-term contracts from established producing areas at the official prices. While Socal does normally buy a small portion of its supplies in the

short-term or spot market, it has not done so at the current, highly inflated spot crude prices. Socal is making every effort to acquire economically attractive additional crude and product supplies. However, any additional supplies of crude oil acquired would be used in the Socal system to make up current shortfalls and not necessarily to produce additional No. 2 fuel at Borco for import into the United States.

4. Chevron Oil Bahamas does not have uncommitted supplies to permit an increase in No. 2 fuel oil shipments to the United States in response to the entitlement change since all excess middle distillates had been committed to its domestic affiliates before the announcement of the $5 entitlement benefit. Production of No. 2 fuel oil might be increased somewhat by COB either through refinery yield modifications or increased crude supplies, but probably only a portion would be available for U.S. import since equity would require increased allocations to all customers.

5. We believe that spot prices for No. 2 fuel oil in Rotterdam and Caribbean markets increased almost immediately following the announcement of the entitlement rule by approximately $5 a barrel. Whether this continues is not possible to determine.

Very truly yours,

D M Mayhum

TEXACO
INC.

2000 WESTCHESTER AVENUE
WHITE PLAINS, N Y 10650

R. HOWARD WILSON
SENIOR VICE PRESIDENT

June 29, 1979

The Honorable Bob Eckhardt
Chairman
Subcommittee on Oversight and Investigations
Congress of the United States
House of Representatives
Washington, D.C. 20515

Dear Mr. Eckhardt:

Reference is made to your letter of June 21, 1979, requesting information on the effect of the $5 entitlement benefit for middle distillates on Texaco's Trinidad refinery operations. Answers to your specific questions are as follows:

1. INDICATE THE MARKETS (IE., EUROPE, U.S., LATIN AMERICA) WHERE NO. 2 FUEL OIL PRODUCED AT THE TRINIDAD REFINERY HAS BEEN SOLD OR DISTRIBUTED BY TEXACO SINCE JANUARY 1, 1979. IS THE NO. 2 FUEL OIL BEING SOLD ON THE SPOT MARKET OR PURSUANT TO LONG-TERM SUPPLY CONTRACTS?

   Since January 1979, No. 2 fuel oil produced at Trinidad has been sold in the Caribbean, Central America, West Africa, Canary Islands, Puerto Rico, and the United States. In addition, quantities were exchanged for petroleum products from Venezuela for Honduras and for lower sulfur No. 2 fuel oil for the U.S. All of these sales and exchanges were made under long-term agreements.

2. SINCE MAY 24, 1979, WHAT VOLUMES, IF ANY, OF NO. 2 FUEL OIL HAVE BEEN IMPORTED INTO THE U.S. FROM THE TRINIDAD REFINERY IN RESPONSE TO THE DOE'S $5 ENTITLEMENT RULE?

   No additional No. 2 fuel oil has been imported into the U.S. since May 24 from Trinidad.

3. AS A RESULT OF THE $5 ENTITLEMENT RULE, DOES TEXACO HAVE ANY PLANS TO BUY CRUDE OIL ON THE WORLD SPOT MARKET IN ORDER TO PRODUCE ADDITIONAL NO. 2 FUEL OIL AT THE TRINIDAD REFINERY FOR ULTIMATE IMPORT INTO THE UNITED STATES? PLEASE EXPLAIN.

The $5 per barrel entitlement does not provide favorable economics for purchasing spot crude which may cost in excess of $30 per barrel, running it at Trinidad, and importing middle distillates to the U.S.

4. WILL THE $5 ENTITLEMENT RULE INFLUENCE OR CAUSE TEXACO TO IMPORT ANY ADDITIONAL QUANTITIES (BEYOND WHAT HAS BEEN PREVIOUSLY PROGRAMMED, IF ANY) OF NO. 2 FUEL OIL INTO THE UNITED STATES BETWEEN NOW AND AUGUST 31, 1979? PLEASE EXPLAIN.

The $5 per barrel entitlement is inadequate to make spot purchases of middle distillates for U.S. imports attractive. We have no surplus middle distillates anywhere in our worldwide system which could be diverted to the U.S. The $5 entitlement rule is an incentive to maximize middle distillate production for import to the U.S. We have been able to acquire a limited amount of additional crude for refining in Trinidad and the U.S. The quantity to be refined in the U.S. is small because of sour crude running limitations. The balance of this crude will be refined in Trinidad, with all of the products being imported into the U.S.

5. WHAT EFFECT, IF ANY, DO YOU BELIEVE THE $5 ENTITLEMENT RULE HAS HAD ON THE WORLD SPOT PRICE OF NO. 2 FUEL OIL?

The $5/bbl. entitlement rule had a definite upward effect on the Rotterdam spot market price when it was announced in early May. However, its exact magnitude is difficult to quantify; and Rotterdam spot values have since declined significantly.

Very truly yours,

R Howard Webster

RHW:amr

Scallop Petroleum Company

One Rockefeller Plaza, New York, N.Y. 10020

Telephone (212) [illegible] Telex [illegible]
TWX [illegible]
Cables SCALLOCORP

Our Ref.
Your Ref.
Date June 27, 1979

Mr. Bob Eckhardt
Chairman-Subcommittee on Oversight
and Investigations
Congress of the United States
House of Representatives
Washington, D.C. 20515

Dear Mr. Eckhardt:

In response to your letter of June 22nd concerning your Committee's evaluation of the effect of the $5.00 entitlement benefit to imports of No. 2 fuel oil, we are pleased to provide the following answers.

1. Scallop Petroleum Corporation has not sold or distributed any No. 2 Fuel produced by Shell Curacao in the period since January 1, 1979.

2. Since May 24, 1979 no volumes of No. 2 Fuel have been imported by Scallop Petroleum from Shell Curacao into the U.S.

3. Scallop has no plans to buy crude oil on the world spot market in order to produce No. 2 Fuel at the Shell Curacao refinery, even were this possible. The current spread between contract prices and the likely cost as a result of processing spot crude, make this route economically impossible.

4. The $5.00 entitlement does not close the gap between contract and spot prices, so that imports are not currently contemplated.

5. There was an increase of over $5.00/bbl in the Rotterdam market immediately after the implementation of the $5.00 entitlement, but within 14 days the market had gone down about $2.50/bbl. Since there is no way of knowing what might have happened to the price had the entitlement not been granted, it is strictly a matter of opinion as to whether the entitlement will cause a longer term increase in world prices.

We note references in your letter to "Scallop (Shell)" which are not clear to us. Scallop Petroleum Company is an operating division of the Scallop Corporation a Delaware Corporation, which itself is a wholly owned company of the Royal Dutch Shell Group.

Sincerely,

G. H. BYE
General Manager-Sales

Mr. ECKHARDT. Mr. Moffett.

Mr. MOFFETT. If the Chair is through with his questions, thank you.

Sometimes I get the feeling—we have had a lot of discussions over the past couple of years, Mr. O'Leary, and sometimes I get the feeling that it is our last discussion coming up. I don't know why, but sometimes it strikes me that I am going to see you for the last time, and so I just want to say——

Mr. O'LEARY. Do you know something I don't know, Mr. Moffett?

Mr. MOFFETT. No; certainly not, not about that anyway. You know I can't help but say this, and some people have written in recent days that I have matured, so I won't go into a tirade about it, but it does upset me.

It is not surprising when I hear conservative Republicans in this committee or any other committee address this issue and not say one word about human misery or human deprivation. It is not surprising when we hear not one whisper from them about this deadly combination, this time bomb out there, and forgive me if it sounds scary, but it is, of AFDC cutbacks, widening gaps in medicare, more out-of-pocket costs, food stamp caps, social security cuts, food price increases, and energy on top of it all, and the impact that it is going to have on people.

I realize that 1980 politics are not your burden, and charting a political course for this President is certainly not your burden and we wouldn't want you to do that. You serve the country and you serve the President, who is the President of everybody. But you also, in an indirect sense, serve a President who is a leader of a party, and I am not an overly partisan person, as you may or may not know, but it seems to me that parties and ideologies are important to policymaking. You would agree with that, I think?

Mr. O'LEARY. I would.

Mr. MOFFETT. Even Ronald Reagan believes that very strongly, and I agree with him. The Republicans play a role here against unreasoned intervention by the Government. There is no question about that constructive role, but Democrats are seen, correctly or not, by the American public and it is reaffirmed in election after election, as being more compassionate, closer to what people are going through, and the Democratic ideology, as espoused in the platform and other places, clearly makes a distinction between the public interest and the private interest. It reflects the fact that you are going to have confrontations between the public interest and the private interest.

When Texaco threatens to turn a tanker around and send it to Europe, that is an obvious clash. When Arco says there is nothing more they can do for us it is an obvious clash. It is not that they are dishonest, criminal, or anything else.

The thing that is disturbing to me, and I won't go on long, Mr. Chairman, but I have to say this—the thing that is disturbing is when you come before us and give us what is essentially the conservative Republican line, even if you think it is right, you blame this problem on stupid policies, on controls, on regulations, in a way it is fitting that your strongest defense comes from conservative Republicans on the committee, people who defend oil companies time and time again against more Government scrutiny or continued Government scrutiny, and I just want to say to you that I don't think that is what the American people thought they were voting for in the majority in 1976.

I believe you are very honest and conscientious and bright. I think you and Secretary Schlesinger are doing what you think is right. But don't make the mistake of thinking that those of us who disagree with you are practicing short-term cheap politics. There is an ideological difference, and the thing that disturbs me is that you are on the other side of it from the majority party in this Congress, as evidenced by the recent vote in the Democratic caucus.

Mr. O'Leary. Let me describe more precisely that by recalling an exchange that is in the record of the House, the Dingell committee of the House of Representatives of some 6 or 8 months ago, and we were discussing then the desirability of imposition of controls or reimposition of controls on middle distillate, or it might have been abandoning controls on crude, and your argument against that was social, and my argument for it was economic, and I said then, and properly, that probably within this administration I had been the most outspoken proponent of social justice here, for example, the intervention funding in 1977 and again in 1978 was, I believe, largely a result of my direct intervention in that process. And I early in the——

Mr. Moffett. That is absolutely true.

Mr. O'Leary. Yes; I earlier said that we must do something in the terms of the energy security fund that would help low-income people. My personal record then I think on this one is all right. Now, at that point I said I saw two problems, one economic and one social, and we should secure the social problem by doing the sorts of things that I have stood for there, the energy intervention and what have you, but we should cure the economic problem by letting the price go up, for example, the crude oil equalization tax. I don't want the oil companies to have that revenue. I do, however, want the economy to live as if it really is in a world of $20 oil, not of $8 or $9 or $10 oil.

Your response to that is that if we did that, we would permit the oil companies to capture, that is if we took care of the social problem we would permit the oil companies to capture, the economic grants. You see there really is the difference between you and me. I have I think as good a record as anybody else in this administration on the social side of this equation, the energy equation.

Mr. Moffett. Yes.

Mr. O'Leary. But I think I cried sometimes almost at what we are doing to ourselves by systematically underpricing, of keeping the bad news away from the market. We ought to keep the bad news in the market, and then compensate people with something like the crude oil equalization tax or windfall profits tax.

Mr. Moffett. Which I voted for.

Mr. O'Leary. I know. But the difference between you and me is that I see the denial of real marketplace economics here as corrosive——

Mr. Moffett. You are right.

Mr. O'Leary [continuing]. As ruining us, wrecking us.

Mr. Moffett. You are right.

Mr. O'LEARY. And I think we ought to take apart this problem of social policy on the one hand, and justice to the oil companies on the other. You know that probably among those people who have worked on this over the last 10 years, I have done more as a regulator to injure the oil industry than anyone in Government.

Mr. MOFFETT. Look, I do not want to drag this on, but the difference is you are right. That is the difference. You cry over the fact that our prices aren't $20 and I cry over what I see happening in my region, and it doesn't mean that either one of us is more correct than the other.

Mr. O'LEARY. But I cry because I see that the absence of $20 in the marketplace gives rise to the dependence that we have now, and this pain and agony that this economy is going through, and will continue to go through, until we get these two problems, social on the one and economic on the other, straight.

Mr. ECKHARDT. Mr. O'Leary, you have been very patient. You have been very helpful to the committee. What I have to say here is not directed as a criticism of you. As a matter of fact, it is as much I suppose with respect to all of our addressing the question, but I look at the Washington Post this morning with the headline, "Oil Price Increase Stiffest Since 1973; House Sharply Weakens Oil Windfall Profit Bill; Gasoline Profits Soar; Crude Drop Continues," and on the other side the doomsday headline "Economy Seen Heading Into Recession."

It reminds me of some lines in "Antigone," Sophocles' "Antigone" more or less adapted by Jean Anouilh:

> Somebody had to agree to captain the ship. She had sprung 100 leaks. The wheel was swinging in the wind. The crew refused to work and were looting the cargo. The officers were building a raft ready to slip overboard and desert the ship. The mast was splitting. The sails were beginning to rip. Every man jack on board was about to drown and only because the only thing they thought of was their own skins and their cheap little day-to-day traffic.

Now that may be true of regulators. It may be true of Congressmen. It may be true of oil companies. And to a certain extent I think it is true of all of us. What I am concerned about here is that we meet a crisis not just between now and fall, but the crisis of overdemand and undersupply, some willingness to meet it concretely. I think that is why some members on this committee, including myself, have said that some regulation to control demand is necessary.

We have talked in terms of a just rationing system. Some of the members on this committee think there ought to be some way to stem the constantly increasing prices with respect to diesel fuel, I mean a doubling of price in a matter of months is shocking to me, and some of us I think feel also that though the concept of a free marketplace may ultimately solve the problems, we do not have it now, and the thing that is facing us more sharply and more dangerously than even the question of energy supply, though it is related to it, is inflation. I think that is our concern, and we hope it is yours to the extent that you will take whatever steps are necessary, not only to supply middle distillates for the purpose of home heating oil, but also to be assured that there is sufficient middle distillates to afford that kind of life's blood of the economy that diesel and No. 2 fuel oil supply.

Mr. O'Leary. Mr. Chairman, let me take this opportunity to tell you what I think you might have to do, you the Congress might have to do over time to handle this. So long as you tell the truckers "Diesel to you is 70 cents a gallon," in a market clearing of $1.50 or something like that, they will have inefficient vehicles without wind spoilers, inefficient routes, and I have been told by truckers, by members of the independents, that they could haul what they are hauling now with half the fuel, if they had the proper rules to do it. So long as we keep the price low, we will continue to burn up an enormous amount of fuel that we need not do, and that is true all over the place. This goes back to the discussion I just had with Congressman Moffett. It is the difference between the economic side of this and the social side of it. I, too, deplore, deplore the fact——

Mr. Eckhardt. If you will excuse me there, I am not taking either the economic or the social side. It seems to me that the two have got to mesh.

Mr. O'Leary. If I may be permitted to pursue this line for just 1 minute longer, it seems to me that we are going to have to reconcile the two and mesh them as you say, and now they are in bitter enmity, and indeed this Congress has wasted over the course of the last 6 years most of its efforts on precisely that debate. If you will take the hours and the intensity of the debate over national gas pricing and crude oil pricing over the last several Congresses, and now over this issue, and put them end to end, they have squandered the Congress energy in dealing with the energy situation. They have been absolutely the consuming considerations, price, price, price.

I think, Mr. Chairman, that you may have to come to this formula. You may have to develop a tax, not an emergency tax, not a crude oil equalization tax, but whatever it is that permits the social objective to be made without the enormous windfalls that will come from the market clearing price that I discussed with Mr. Dannemeyer. I think that given the situation where you have these ingredients—highly inelastic demand for the key product, gasoline, a monopoly supplier—you do not have the classical elements of a market economy, and that means that you are going to have to superimpose something on top of it, because if you get the price clearing, it is going to be a multiple of costs. In classical economics you do not have that sort of a situation, you have freedom of entry that brings you to the point where costs come down and cross with price. In this situation, because of the forced ingredient, that is to say a monopolistic price on the raw material, you cannot have that. I think if you will recognize that, and use that as the point of departure, you will recognize that to have market clearing you are going to have to have a tax or enormous profits to the oil companies.

Mr. Eckhardt. That may be true. That may be true, and I think that is probably for another day, particularly after this headline, but let me just say that until we solve these problems somewhat broadly, we are going to have to try to find some means of both affording supply and also in some way keeping prices from going clean through the ceiling.

Mr. O'LEARY. Congressman, let me suggest that we really have these problems that we must address, that have preoccupied your House and this Congress. The first one is enrichment of the oil companies. The second one is social justice to the consumers of these products, in a period where monopoly pricing dominates and will continue to dominate the situation as far ahead as at least I can see. The third one has to do with adequacy of supply, and really the adequacy of demand, because they are conditioned by the first two. What we have done is we have permitted the enrichment concern, the first of these concerns, to dominate our policy. We have, by our fear of enriching the oil companies, and I think it is a proper fear, we have kept prices down in order to achieve the second objective, which is social justice, and I think in that we have violated the third and fourth, that is to say bringing demand and supply into some sort of balance.

Mr. ECKHARDT. Let me just say this. You may be right, and it may be that a different philosophy from that which was established by Congress in the last several years is a correct one. Certainly, of course, we have a constantly changing problem with respect to economic and social problems.

The thing, though, that has concerned me all of the time I have addressed this energy question, is that every time Congress puts into effect one policy, the administration has put into position administrators who do not believe in that policy and will not carry it out.

It reminds me of an essay that was written by George Bernard Shaw titled "Why Not Try Christianity?" Have we ever tried regulation? We have had hearings here with respect to what is being done about gasoline prices. I find no regulation to be in effect. I have heard your counsel here say I think and suggest that you are now working on a program that may possibly work in regulating the price of gasoline.

Mr. O'LEARY. Congressman, I think that that——

Mr. ECKHARDT. But it has not been put into effect in the past.

Mr. O'LEARY. Congressman, what you have here is at the outside 2 percent of the price as a result of people being a scofflaw on average in this country today. I do not think that there is more than 2, at the outside 3 cents of violations, and I am quite sure that in today's market the person with gasoline, if he were a scofflaw, instead of charging where he should charge 82 cents, charging 85 cents, could charge 95 cents or $1.05 or $1.55 and sell the products.

Mr. ECKHARDT. Mr. O'Leary, I do not want to argue about the percentage involved. What I am suggesting here, though, is that with respect to every type of regulation that Congress has put into effect, I find much more effort on the part of the administration, and I am speaking of the Nixon administration, the Ford administration, and indeed the Carter administration, much more time expended on determining means by which regulation can be done away with than effort with respect to how it is to be enforced, and I hear much of the philosophy you are espousing from this table as philosophy entirely contrary to that which has been established by Congress.

The Constitution says that Congress shall make the laws, and it says that the President shall faithfully carry them out. Now that I think is a pretty good general rule with respect to operating this country, and I have not seen it occur in three administrations now, and I think it is time that, though Congress has many debilities itself, which I recognize immediately, I think it is time that we attempt to enforce the law that we have established and the policy which has been properly put into effect by legislative action.

Mr. O'LEARY. Mr. Chairman, let me respond to that by saying that the Congress has provided a law and the result of that law is that we now have price controls on crude produced in this country, and we have a very active enforcement program to see that that is not abused, and on one principal product, and that is gasoline, and I will tell you that although you do find some rather dramatic abuses, on average the abuses are on the order of 2 to 3 percent.

Mr. ECKHARDT. I suggest you talk to U.S. Attorney Tony Canalles in the Houston area, who has got most of these big companies within the jurisdiction of the Southern District of Texas, if you think those abuses are small.

Mr. O'LEARY. You know, Tony Canalles gets his cases from us, after we have developed the case. We pass them on to him, and he is the prosecutor for those cases, and so we are intimately familiar with the things that he has before him. The principal area where we are finding really willful violations is in the crude resellers line, as you know, and there we are moving to develop a remedy.

There are a 100 people right now working for us, let alone what the Department of Justice has, working on those crude reseller cases.

Mr. ECKHARDT. Let us end the hearing with that happy note.

Mr. O'LEARY. All right.

Mr. ECKHARDT. I hope they continue in their effort.

Thank you very much.

The next witness is Mr. Gordon Barnes.

Mr. Barnes, do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

STATEMENT OF GORDON BARNES, METEOROLOGIST, WDVM-TV

Mr. BARNES. I do.

Mr. ECKHARDT. You may proceed.

Mr. BARNES. I have no opening statement, Mr. Chairman. Being in the television business, I am used to being the last person on the 11 o'clock news at night; when the news and sports run long, you cut the weather man. I will keep my points short and to the point. I will take your questions.

Mr. ECKHARDT. Mr. Moffett.

Mr. MOFFETT. I am anxious to hear what the witness has to say.

Mr. ECKHARDT. He said he would take questions.

Mr. MOFFETT. I see. I think what we would like to know, Mr. Barnes, is generally your assessment for the upcoming winter. We have heard from so many people who have responsibilities in the marketplace and in Government, oil companies in particular, but some Government people, that they are planning on a pretty much normal winter, or at least their assumptions envision a normal winter. We have heard from Mr. O'Leary, as I understand it, that he is projecting a winter that is 5 percent below normal.

Could you tell us what you think the winter will be like, first in general terms, in terms of temperature, second, if you could divide it up into earlier and later time periods. Cities Service testified yesterday that essentially they are going to try and rob Peter to pay Paul, and they think that they can make it through the early part of the winter by essentially taking supplies of heating oil that they had planned for the early part of the winter, and preparing to utilize that in January and February.

There is an assumption, it seems to me, that the early part of the winter will be rather mild, and if it is not going to be, I think that we would like to know that. We understand, and I am sure you would put this caveat in, that this is an inexact science. There are even some who say you cannot do it, so what we are trying to do here is get an assessment from you as one who is recognized as one who has done it in the past, and might just be right again. Certainly you know a lot more than we do or anyone we have heard about the weather forecasting.

Mr. BARNES. All right. What I would like to do is break down the country into several sections, and break it down for each month so that you can have a better picture of it.

We will start off and discuss the northeastern plains and Great Lakes, which comprises the Dakotas, Minnesota, Wisconsin, the upper Michigan peninsula. I will do it only with respect to temperatures in general.

For the month of September, the temperatures will be above normal. The reason I start with September is because I would like to make a comment before I leave regarding rule 9. October, below normal; November, below normal; December, normal; January, well below normal; February, below normal; March, normal.

The Midwest, where I include Nebraska, Iowa, Illinois, Indiana, Michigan: Above normal for September; slightly below normal for October; below normal for November and December; well below normal for January; below normal for February; and normal for March.

The central south plains, Kansas, Missouri, Oklahoma, Arkansas: September, above normal; normal in October; below normal for November and December; well below normal for January; below normal for February; and also below normal for March.

The Ohio Valley: September, above normal; October, normal to slightly above; below for November, December, January; well below for February; and below for March.

The Mid-Atlantic States, including Washington: September, above; October, normal to slightly above; November, normal; December-January, below; February, well below; and March, below.

New York, New Jersey, and Pennsylvania: September, normal; October, normal to slightly above; November, normal; December-January, below normal; February, well below; and March, below.

For New England: September, below normal, because of an unusual situation; October, normal to below; November, normal; December and January, below normal; February, well below; and March, below.

Taking those areas and from the period September 1 through March 31, the temperatures should average out a minimum of 12 to 15 percent below normal, with the greatest impact during the period December 1 through March 1.

Mr. MOFFETT. Can you tell us briefly what your forecast was for last year and how it came out?

Mr. BARNES. I testified last July before Congressman Brown and Congressman Fuqua's Committee on Science and Technology and stated that temperatures this past winter would average some 12 to 15 percent below normal, and it averaged out between 14 to 18 percent. I was a couple of percent off but I was on the right track.

Mr. MOFFETT. How about on snowfall? We know last year that Chicago, for example, had a very bad time.

Mr. BARNES. I had indicated that general snowfall would be at least 20 to 25 percent above normal. Minus the areas including Washington that had the blizzard-type storms, it averaged out fairly close to the estimate.

Mr. MOFFETT. And what about snowstorms for this year?

Mr. BARNES. I am forecasting a minimum of five major snowstorms for the period November 1 through March 1, extending from the Midwest to the Middle Atlantic and New England States.

Mr. MOFFETT. So this has implications for the use of diesels in those trucks, the snowplows, and so forth.

Mr. BARNES. That is correct—runway, snow removal for runways, airports, for your major highways, and also for your major cities, which are really having difficulties as evidenced in Chicago.

Mr. MOFFETT. How do the five major snowstorms compare with other years?

Mr. BARNES. Well, through 1976 it is way above average, but what we have had for the last two winters, it is about the same.

Mr. MOFFETT. Now snow acts as an insulator of sorts, does it not?

Mr. BARNES. That is correct.

Mr. MOFFETT. Do you see that being helpful? When you say that we have 12 to 15 percent below normal temperatures this winter, is there any way you can help us try to get a handle on how bad it will be in terms of heating use? I know you are not an expert in that and we are not trying to make you out to be one, but will we have, for example, consistently high levels of snow so that we will have that insulation, or will the spring, for example, be cold without snow?

Mr. BARNES. The first part of the winter, that is through the end of the year, you will have a higher demand, I would assume, for heating oil for homes, because of the lack of snowfall. The heavy snowfall will occur during the months of January and February, where the demand will be comparable to what we had this past season, and believe me I work in this every day. I do not have any major oil companies as private clients. I do have individual dealers, and I have a lot of farmers who use my forecast service, and these forecasts have been prepared already for them.

Mr. MOFFETT. Can you tell us something about what one of your farmer clients can look forward to?

Mr. BARNES. Well, that is where I would like to make a comment on rule 9.

Mr. MOFFETT. Yes, please.

Mr. BARNES. We have already heard this morning that we had a very late planting season for corn and for soybeans through the

Midwestern States, where the corn is late in growing—it is only up to 8 to 12 inches in some areas right now. What we need is some very warm temperatures to get it to grow. Not only will we have warm temperatures, we are going to have some very hot temperatures, which will create a bit of a drought problem in some States, but the problem really is going to be the harvest, which will not start until probably the middle or end of September, because of the late planting.

The combination of the above-normal temperatures through the basic main Corn Belt States in the month of September also indicates that we will have below normal precipitation, so we can get off to a good start, but then when we get into October, which is the key month for harvesting, we will have excessive amount of precipitation, which is going to create problems for the farmers for their harvesting, and we had better be ready to give the farmers all the help, because not only do I forecast for the United States, I also forecast for Europe, Russia, and China.

Russia right now cropwise is in deep trouble. This has already been indicated in our commodity markets where they have been buying. China will probably come into the market sometime in the fall. The demand for our crops in the fall of 1979 will surpass the demands of 1977 and 1978. We had better have the oil ready for the farmers to get their crops to the market.

Also at the same time, during the month of November, the farmers are preparing their fields, as you know, for next year's planting. Here again it will be a wet November for the key planting States.

Mr. Moffett. Mr. Johnson, from the Minnesota Energy Agency, yesterday was speaking of the spring, the last spring in Minnesota, and he said the planting season was delayed due to cold and rainy weather. Thus the demand for diesel fuel for agricultural use was concentrated in a few weeks at planting time in late May and early June.

Now do you think that situation is going to be basically the same out there?

Mr. Barnes. Yes, because there was a further problem that complicated it, because we had heavy rain and the floods of the Red River Valley. We had late snowfall in that same area and most of the diesel supply—at least to my farmers down through Redwood Falls and Worthington, Minn.—their diesel oil supplies were underwater in Grand Forks, N. Dak. There was no way to get the diesel down to them, and they had just finished planting.

Mr. Moffett. Now what about the places where we use home heating oil the most, the Northeast part of the country? Can you go over that very quickly, and how it relates to the Northeast?

Mr. Barnes. For the Northeast, the snowfall will be below normal right through the end of the year. The heaviest snowfall once again will be in the months of January and February. Therefore your demand for home heating oil should increase or at least be high for those two months, because as we indicated, snow does act as an insulator, and if you have snowfall on the roof of your home, or around the foundation, basic law of meteorology applies, and that is cold air is heavy and sinks and warm air is light and rises. If you have got cold air on top of your house and surrounding your house and it is correctly and tightly insulated, there is no way that warm air can escape.

I just bought a new home in McLean and spent $2,000 just on storm windows alone and I have already reduced my bill 40 percent.

Mr. MOFFETT. Thank you. Thank you, Mr. Barnes.

Thank you, Mr. Chairman.

Mr. ECKHARDT. Thank you very much.

Mr. BARNES. Thank you.

Mr. MOFFETT. Our next witness is Mr. Robert Harkins, the vice president of scientific affairs in behalf of the Grocery Manufacturers Association of America. Welcome. Would you please stand and raise your right hand.

Do you swear to tell the whole truth and nothing but the truth, so help you God?

STATEMENT OF ROBERT HARKINS, VICE PRESIDENT, SCIENTIFIC AFFAIRS, GROCERY MANUFACTURERS OF AMERICA, INC.

Mr. HARKINS. I do.

Mr. MOFFETT. Please be seated.

Mr. HARKINS. Thank you, Mr. Chairman.

Mr. MOFFETT. Mr. Harkins, we will make your statement without objection part of the record, and if you would like, you can summarize it or you may read it.

Mr. HARKINS. It is short. I think it might be easier, Mr. Chairman, if I read it directly.

Mr. MOFFETT. Please.

Mr. HARKINS. I am Robert W. Harkins, vice president, scientific affairs, of the Grocery Manufacturers of America, Inc.—GMA. GMA is the national trade association of the grocery product manufacturing industry. We are a nonprofit organization that has been serving our membership and the public since 1910. Our member companies and cooperatives produce food and grocery products sold in virtually all supermarkets and other retail grocery outlets in the United States.

We appreciate this opportunity to appear here today to express the concern of our industry regarding the impact of the middle distillate shortage on our Nation's food economy. As a result of the current shortfall, the transportation and processing ability of American food manufacturers and processors is being hampered.

Let me explain our concerns relative to middle distillates. First, there is an immediate and critical need to insure the safe and timely delivery of food commodities to manufacturing and processing plants as well as to retail outlets. Spot food shortages, particularly of seasonal fruits and vegetables, are already occurring. If the situation is not resolved quickly, major shortages of food products will soon be felt by consumers all over the country.

Second, even after the trucking situation returns to normal, a serious shortage of middle distillates will still exist. Middle distillates are used in the food system in two important areas: No. 2 fuel oil is used in trucks and locomotives. This same category of fuel is used to heat private residences. In essence, each of these uses—as a processing fuel, as a distribution fuel, and as a residential fuel—

must compete with each other. One cannot say that one use is more essential than another. They are all in the highest category of priority.

Within the GMA membership, about 8 percent of all energy consumed in processing food products is supplied by middle distillates. As the supplies of natural gas have diminished in recent years, manufacturers have gradually shifted to middle distillates.

A summary of our recent energy conservation report which summarizes fuel usage information is attached as part of our testimony. In GMA's latest report to the Department of Energy, our members reported an energy efficiency improvement of 17.4 percent for calendar year 1978 as compared to calendar year 1972.

Recently our members have begun to experience reduced allocations of middle distillates. During the time that special rule 9 was in effect, stationary uses of middle distillates received adequate supplies, although the transportation allocation was of limited value. Since the revocation of special rule 9, agricultural users of middle distillates have encountered a new and difficult set of circumstances.

We received a call yesterday from one member company who reported on their experience in Wisconsin. Their plant has been told by its supplier that it will receive significantly reduced amounts of middle distillates. This is a seasonal facility which typically would can locally produced fruits and vegetables for a short period, typically 12 to 15 weeks. With such highly perishable foods, nutritional value is significantly altered if processing is delayed as, for example, when fuel supplies are in short supply. A repetition of this scenario across the Nation will result in decreased food stocks. Reduced supply in the face of continuing demand will have a dramatic inflationary impact on the cost of food. If at all possible, such a situation must be avoided.

We urge you to address this concern. The American people must be assured of an adequate, economical supply of food.

Mr. Chairman, I would be pleased to respond to your questions.

Mr. Moffett. Mr. Harkins, I want to thank you for your testimony. I know that the members of the Grocery Manufacturers of America are extremely concerned about this situation. They have approached us. They have approached other Members of the House. They obviously believe that we ought to have some rationing system with regard to distillate priorities, and that we ought to bring some reason and accountability to this system. Those of us who are so concerned about this within the House believe the same as you do, and we look forward to your being an ally with us on this issue, to try and have this policy established.

We thank you for your testimony.

Mr. Harkins. Thank you very much, Mr. Chairman.

Mr. Moffett. Our next witness is Mr. Thirman Milner. Please remain standing.

Do you swear to tell the whole truth and nothing but the truth, so help you God?

STATEMENT OF THIRMAN L. MILNER, REPRESENTATIVE, CONNECTICUT STATE LEGISLATURE

Mr. Milner. I do.

Mr. MOFFETT. Mr. Milner, it is certainly a great pleasure to welcome you as a representative from the Connecticut State Legislature. Would you please state your name and your affiliation.

Mr. MILNER. My name is Thirman Milner. I am State representative from the seventh assembly district in Hartford, Conn.

Mr. MOFFETT. Mr. Milner, we do have your testimony, and without objection it will become part of the record. You are free to either read it or summarize the testimony at this time.

Mr. MILNER. Mr. Chairman, my testimony is rather brief. I would rather read it.

Mr. MOFFETT. Yes.

Mr. MILNER. First I would like to thank you and members of your staff for the efforts that you made in having me here today.

Mr. Chairman and members of the committee, my name is Thirman L. Milner. I am a State representative from the Nutmeg State of Connecticut.

A large majority of my constituents are some of this Nation's poorest citizens. It is estimated that in Connecticut's capital city of Hartford, in which my district lies, over 80 percent of all public schoolchildren receive some form of public assistance.

We have a crisis. Those that I am here to represent do not have the luxury of lobbyists to speak in their behalf nor the funds to appear in person. I have also found that regional hearings are not as effective as hearings held at our Nation's capital nor are they as well attended. I feel that I can speak as a representative of this group, not only because I was elected to do so, but because I am the product of a large welfare family, and even now, as a State legislator, I am not in the realm of the status of what is known as middle-class American.

The energy hearings that have been going on in this Nation's capital are the most crucial hearings that will take place before any branch of our Federal Government, because it deals with the health, safety, and lives of millions of American citizens.

According to a recent paper put out by the Fuel Oil Marketing Council of the Department of Energy, the average low-income household spends approximately 30-percent of its annual income on energy. With the rising cost of home heating fuel, I predict that for many households this will rise close to 50 percent this coming winter.

At a 30-percent cost level, low-income families in 1978 suffered a purchasing power loss of more than $8 million. Poor people pay a disproportionate percentage of their income for energy use. The quality of housing stock for this group compounds that fact.

Since 1972, the average total income of the poor has decreased in real values, yet the fact remains that the poor pay more in the marketplace. For example, for economic reasons most companies reduce the cost of fuel, gas and electricity for large orders and increase the cost for smaller ones. The average middle-class and the low-income family neither has storage capacity nor the credit line to make large purchases. They are forced to pay the higher rate of cash on delivery.

Major public assistance programs have not made up the inflationary gap for those who must turn to welfare programs. This past session of the Connecticut State General Assembly we were only able to pass a 5 percent cost-of-living increase in the State's welfare budget, which is presently at the 1974 cost-of-living level. This will keep a large segment of our population at a dependent level that will provide no additional funds to meet the rising food, clothing, medical and living costs, yet alone energy. At the same time, our State's public utilities commission is about to approve an 11-percent increase in utility rates for the major electricity supplier in Connecticut.

Our residents are being asked to cut back in energy usage. The poor, handicapped, disadvantaged and elderly have been forced to cut back so much already because of economics that any further cutbacks will be at the risk of endangering their health and their lives. They are the ones being held hostage by this entire energy situation.

It is estimated that over 20 million American households will not be financially capable of meeting the pending home fuel oil crisis. Over one-third of these are our elderly citizens on fixed incomes. Not only do these citizens face health problems, but they also face serious emotional and mental conditions that result from the panic of not knowing if or how they will keep from freezing in the middle of winter. This is a real and serious problem. Alternate energy sources are not going to assist the middle and poor of our Nation, even with Federal rebates. The cost remains too high.

I have come here with several recommendations that I urge this committee to study and to pass on to the Department of Energy, our Congress, and to our President:

One. The establishment of the program to assist poor and middle-class Americans this winter, a program that will be in place before the winter months arrive. I have studied, in part, the Jackson-Javits bill S. 1280—a bill to establish a program to assist low-income elderly and others in meeting increased primary residential fuel costs. The concept of this bill is good, but it addresses only those Americans eligible for food stamps, AFDC or SSI. The bill also places ceilings that are not realistic for eligibility criteria.

I urge adoption of a Federal energy assistance program that is based on individual household energy needs, not fixed amounts per household. The eligibility income level should be high enough to take into consideration those who have previously been classified as middle income but do not enjoy the luxury of finances for that distinction. Any such program should guarantee that eligible households may retain their principal energy source of supply. This will prevent the squeezing out of the small and minority vendors who have historically been the major fuel oil suppliers, especially within our urban centers.

Energy assistance programs are not handouts, but programs that assist our economy by producing the expansion of the recipients' purchasing power for food, clothing, health and other essentials. An energy assistance program should not just provide subsidies, but energy audits, conservation and weatherization projects as well.

The best vehicles for the operation of such a program are the community action agencies across the Nation. These agencies have established a network of communication between themselves and the poor and disadvantaged of this Nation. Federal or State programs administered by municipal governments have proven to be too costly and bogged down with redtape and paperwork.

There are many sources for funding such a program, including utilizing oil import tariffs, the crude oil equalization tax, refiner rebates that DOE receives, general revenues on the Federal gasoline tax, et cetera.

Two. The release of Federal funds that will allow for the employment of workers to carry out the weatherization programs.

It is my understanding, Mr. Chairman, that there are warehouses across this Nation full of weatherization materials that have been paid for by tax dollars but cannot be used because the moneys for workers employed formally under the CETA Act have been cut from the budget. Now is the time for weatherizing homes, not in the middle of the winter.

Three. The establishment of a Federal minority energy commission as recommended by James Monroe, a member of the U.S. Small Business Administrations' Fuel Oil Task Force and owner of Connecticut's second largest minority fuel oil company, Oasis Oil. In New England no minority dealer has direct contracts with a major oil company, making them dependent on the dictates of secondary distributors and their ability to supply. No minority dealer has storage capacity, credit, or ready cash to build a hedge against fuel shortages or increasing costs. This commissions them to face the evergrowing possibility of not being able to replace their supply because the price of fuel is increasing so rapidly that each time they make a purchase they will be buying less with the same dollars. These dealers will be placed in a bidding war with major dealers and secondary suppliers.

Present energy planning and policy deal mainly with the major oil companies, secondary distributors, the consumer, and Federal subsidies. The minority and small oil dealers are the missing, but necessary, link. These are the main suppliers in our urban areas and the ones that have been depended on in the past to carry out the delivery system of the emergency fuel oil program on a 24-hour basis.

A commission, separate from but with direct input to present energy commissions would provide advocates for the poor and middle-class consumer and minority and small vendors who are in many cases the only source of supply to our urban areas.

Four. Establishment of a nonprofit Federal corporation which will have the power to purchase foreign crude oil and petroleum products as proposed by Representatives Benjamin, Conyers, Rose, and Rosenthal under H.R. 3604, the Oil Imports Act of 1979. Such a corporation could regulate the distribution of oil products more fairly and, I am sure, at a more reasonable price. I realize these are drastic steps, but these are also drastic times.

Five. The establishment of an emergency energy policy that will guarantee that the number one priority for fuel heating supplies this winter will be for home and hospital consumption, even if it means cutting back on allcoation of No. 2 heating oil to business, industry, and Government facilities. Most of these facilities can use No. 6 fuel oil. No. 6 fuel oil has a higher pollution level and may not meet our strict environmental code standards, but can be used without endangering lives.

I do not have the same hope or confidence that Deputy Energy Secretary John O'Leary has that oil companies can rebuild their oil stocks of No. 2 heating oil before this winter.

Mr. Chairman and members of this committee, something must be done and done now. We cannot wait on the OPEC nations, more studies, more proposals or the optimism of the Department of Energy. Winter is not far off and unless something is done now, we will face the most disastrous crisis of our time and those who can least afford it, the poor, disadvantaged, handicapped, elderly, and minorities, will once again find themselves at the mercy of a government that acted too late and did too little.

I urge you not to just let this testimony go down for the record and not go back to business as usual, but for each of you to be a lobbyist for your poorest constituent and enact emergency measures that will be accepted and adopted by the President that will meet the energy need of every American.

I thank you.

Mr. Chairman, I do not believe that any testimony I have heard or comments from you or any member were fear tactics, it is an actuality, we are faced with it and it will be true unless something is done drastically and done now.

Thank you.

Mr. MOFFETT. Thank you. I could not agree more.

I really do think, as I said to Mr. O'Leary, if he came up and saw the situation in our area generally and the area you represent specifically, I do not think that he would perhaps feel the same way that he does about the energy situation.

Last year consumed a chunk of emergency fuel assistance fund reluctantly released by the administration. They really did not want to release it, but it was based on a continuing resolution. Some of us went to the White House in October and urged that it be done, and finally their legal counsel at the Office of Management and Budget told them that they had no choice and they released the funds.

Now the amount has been cut from $200 million this year down to virtually nothing. An amendment offered by our colleague from Connecticut, Mr. Dodd, was defeated on the House floor the other night despite the fact that we pushed for it. The Department of Energy of course did not push for it. That is one of the things I wanted to mention to Mr. O'Leary but I did not have time.

If we go through another winter, and you heard the weatherman say that it could be 12 to 15 percent below normal, if we have heating oil at 90 cents or more per gallon, it will be $1 if they import a lot of the distillate, and if we do not have a fuel assistance program, what is going to be the impact on your constituents, on your neighborhoods?

You know it is interesting now. This is a beautiful city, when you go home you see the leaves out and even in your area the kids are out on the street playing and there is a frivoloty about it all. The troubles from last winter it seems to me are still there; it is being covered up. We are headed into another winter in twice as bad shape.

Mr. MILNER. Mr. Chairman, I agree, I think this winter is going to be much worse. The last winters when they had the emergency assistance program allowed something like $250 a single shot grant to families. At that time fuel oil was selling anywhere from 47 to 57 cents a gallon.

Mr. MOFFETT. What was the bill to the average person who was getting that $250?

Mr. MILNER. The average bill ran somewhere close to $100, $150 a month if you rounded it up for a 5-month period. This year we are talking about $150 per month, if you are talking about $1, because during the winter months the average consumption is 250 gallons of fuel oil. Unless something is done, someone is going to freeze this winter.

Mr. MOFFETT. What is happening with the winterization programs now in the inner city?

Mr. MILNER. They are at a standstill. Our understanding, the problem is that they have not allocated money for the CETA workers and the supplies are stored in the warehouse and nothing is being done on weatherization now.

Mr. MOFFETT. You heard me say to Mr. O'Leary it is unbelievable that we could have a Democratic administration take this position which is essentially letting the social side, as he likes to call it, slide, letting it slide and pretending that somehow it is separate from the economic side, when we have much longer welfare lines, food stamp lines, much greater human misery, plunging into a recession as Congressman Eckhardt said, and as the newspapers so rightly said this morning.

I want to thank you for your testimony, on behalf of three subcommittees who have sponsored this hearing. We thank you for taking the time to come down here and give us this excellent testimony. We assure you, those of us who feel the way that you do, that it will not simply become part of the record, that it will be quoted and requoted again and again with the hope we can get some attention of some of the people in the executive branch.

Thank you very much.

Mr. MILNER. Thank you very much.

Mr. MOFFETT. If there are no further questions of the staff, the subcommittees stand adjourned.

[Whereupon, at 2:12 p.m., the subcommittees adjourned, to reconvene subject to the call of the Chairs.]

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