Transcript of Proceedings

BEFORE THE

DEPARTMENT OF ENERGY

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In the Matter of:

NATIONAL PETROLEUM COUNCIL

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S K S Group, Ltd.
1400 Eye Street N.W.
Washington, D.C. 20005
(202) 789-0818

BEFORE THE DEPARTMENT OF ENERGY

Wednesday
December 12, 1984

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The above-entitled matter came on for council meeting pursuant to notice, before Chairman Robert A. Mosbacher, presiding Administrative Law Judge, at The Madison Hotel, 15th and M Street Northwest, Dolly Madison Ballroom, Washington, D.C., at 9:30 a.m.

APPEARANCES:

Panel:

Marshall W. Nichols

Honorable William A. Vaughan, Judge

John K. McKinley

Honorable Donald Paul Hodel, Secretary of Energy

Robert A. Mosbacher, Chairman

Audience:

Robert L. Parker

George P. Mitchell

APPEARANCES: (Continued)

Frank Pitts

H. A. True

John Rex Jones

Richard J. Gonzalez

Cliff W. Trice

James W. Glanville

Fred L. Hartley

William Carl

Cary M. Maguire

Jack Allen

John H. Lichtblau

Harold Pruner

Gordon D. Goering

James Borden

James F. Gary

John A. Baden

John G. Phillips

CHAIRMAN MOSBACHER: Welcome to today's meeting of the National Petroleum Council. We will, with your permission, dispense with the role call. I hope each of you has made your presence known, just outside the door. And if you have not, please do so immediately following the meeting in the executive chamber or immediately outside the door.

I'd like to introduce people at the head table. On my far right is Marshall Nichols, the able executive director of the National Petroleum Council. Next is the Honorable William A. Vaughan, assistant secretary for fossil energy. Next to Bill is John McKinley. John is chairman of the committee on U.S. petroleum refining.

And next to him, known to all of us, is the Honorable Donald Paul Hodel, Secretary of Energy. We are delighted you are here, Mr. Secretary and waits your words.

SECRETARY HODEL: Thank you very much, Bob.

It is a special pleasure to be here today. After going to the reception last night, of course, I had to change suits because of all the sweaty palm prints on my lapel. So I knew that there was some interest in some of the topics that might come up here today.

Let me say just right off the bat that I recognize as Secretary of Energy how tremendously important the oil and gas industry is to the United States of America. Make no mistake that I have no illusions that this industry is anything other than the first largest, most significant supplier of energy to this country.

And therefore, when I give speeches, and I do, and I will talk a little bit about that here today, that talk about the balanced and mixed energy supply that we see necessary for this country, that does not mean in anyway that I am downgrading the significance or importance of oil and gas. Some of the other things we'll talk about today will be premised on my recognition of that, and the role I think the Secretary of Energy ought to be trying to play, or ought to play as a spokesman for a major component of the energy industry.

But first, let me say that a friend of yours and mine, Charlie Murphy, who's chairman of the board at Murphy Oil, has written and asked to be relieved of his NPC duties. He served us 22 years. That's the second longest tenure of any current member, and I didn't do my homework to know who the longest serving member is. He served on dozens of committees, of course. And he's had one of the best attendance records. And I do not believe that the fact that he couldn't come to this meeting is the reason why he has asked to withdraw.

He is not here with us this time. Obviously we will yield to his request with regrets and great appreciation for the service which he has provided us as a member of this extremely important council. I think it would be appropriate if the record would show that you joined me in applauding Charlie for his long years of dedicated service to the National Petroleum Council.

Now, there's a lot that's happening in the energy market these days, not just in oil and gas, in the energy market. I would like to set the context for my remarks by talking about the development that we're going through, the development process that we're going through for the next national energy policy plan, which is expected to be submitted in April.

It is apparent from the discussions that we're receiving in the various hearings and meetings that we have, that our goals and strategies that we've stated in the past are fairly sound. Remember our goals in adequate supply at reasonable cost? Nobody has really taken me on and said that we should have an inadequate supply of unreasonable costs. I haven't been surprised by that. It's worked very well as a general goal.

The two strategies I'll remind you are, first, that we ought to minimize Government intervention and control in the market place, recognizing our health, safety and environmental responsibilities. And secondly, that we need a balanced and mixed energy supply. And we talk about an array of resources that are available.

What's coming through in the discussions -- what's coming through in the discussions is that what we ought to have is a set of substrategies, which would focus our efforts and permit us to have our programmatic activities react more specifically to some of the proposals. Now, I have often said that our second strategy can be likened to the balanced and mixed -- this is balanced and mixed strategy.

We've got the conventional resources, which I envisualize here. We've got renewables, and these, as you will note, are not proportional to the supply that these various resources provide to the society in conservation. Under conventional we've got oil, gas, coal and nuclear. And under renewables we have hydro, solar, and wind, and geothermal, and ocean thermal energy, and et cetera, bio fuels and the like.

Under conservation, we usually divide that into two parts. Is that even remotely legible?

: Yes, sir.

: There's something here that doesn't look legible.

SECRETARY HODEL: As long as it isn't smoke filled I don't care.

We talked about efficiency, and we talked about savings. Efficiency, to me, is where you get the same amount of work done but you're using less energy. You fellows are going to have trouble seeing this with me standing here.

: No problem.

SECRETARY HODEL: All right.

I'll wake you when we're finished.

Efficiency is where we drive as many miles, or more miles, but we don't use as much oil or gas. Good savings are where we just plain use less.

We've looked at these strategies and looked on them as supplying us with some of the rationale for the programs which we've set forth. We've had an R and D activity, which is intended to underline this whole area. You can look at the R and D expenditures that we've been making, there is some rhyme or reason to them, as we see it. That is, you'll find that with established technologies we are not doing a lot of basic research on ways to convert those fuels into energy.

We're doing research in the oil area on such things as enhanced oil recovery, seeking to improve the upgrade. Gas, similarly. In coal what we're spending our money on is largely on ways to either clean it before you burn it, burn it cleanly, or clean the stack after you've burned it.

In case of nuclear, we're doing the health and safety research on that part of the frontier that people raise their greatest concerns, and we're also looking at advanced technology, and so on down the line. So what we are trying to do is, as I keep suggesting, is we're trying to expand with the energy frontier so that the private sector can come along and develop, for the benefit of the society, those resources that make the greatest sense. And I mean in particular the economic sense.

That is the background and frame work with which we approach some of the problems I'd also like to talk about today. There's been a lot of talk about the world oil market, and what's happened. As you know, I gave a speech in London about mid-October, which some of you may be aware of. The history of that speech goes back a ways.

In August there was substantial downward pressure on the price of oil. The British Government allegedly sent a letter to oil companies in Great Britain suggesting that they not lower the price. That's allegedly what was in this alleged letter. We did not say anything publicly about that. But we did protest diplomatically to the British. And by that, I don't know how diplomatic the protest was, I know it was through diplomatic channels. I assume it was also made diplomatic.

We suggested that they should not be attempting to prop up the price, nor should we be attempting to drive the price down. Our view has been throughout to market our control price, and that that's where we ought to be headed. Our silence was interpreted by a number of people, including some of you in this room, as well as many outside this room, and certainly several in OPEC, that acquiescence on the part of the United States Government in a process where a policy of propping up and holding the price at $29 a barrel.

For those of you who know this

administration as well as most all of you do, know that that is not our policy. It would not be our position. But it was clearly perceived as such because we didn't say or do anything about the British action.

I had previously accepted the speech at the oil data conference in London to a group of petroleum people from all around the world. And it seems to me that that was the appropriate form at which to make plain our policy has not changed, and that we do not favor, I would say artificially propping the price. But that we think the price should be determined by the market process.

Now, our argument -- my speech was couched in terms of stability. And this begins to sound an awful lot like "1984", where -- and I mean the book "1984" -- because the immediate prior speaker to me was the head of Petromin. And as he spoke, his thesis was stability. And stability was quite clearly a price which was determined by OPEC for producers at a fixed level. That's a stable price. Now, certainly that's a clear understanding of the term.

Following the market, which might look something like this, variously, it's not perceived stable, like some people. My argument was, and is, that a stable price is one which is not subject to massive swings or drops, that that is an unstable price. And that the reason I'm concerned about the price being set at $29 a barrel, U.S., is that the curves that we've seen is that prices held. And as the market supply/demand established market drops away from that price, my concern is that eventually, eventually they will be unable to hold at $29 a barrel.

And when the break comes, the price won't drop just to what the market would've dictated. But it may very well drop below that and I don't think anybody can tell us today what the bottom is for oil price per barrel in the event of a price break of a significant magnitude.

That kind of instability is not in the interest of producing nations or consuming nations and vice versa. The long term effect of that kind of a result is that a tremendous disruption will occur at some level and will drop the price in the ability to produce, explore, transport and utilize that fuel. If that happens then we, the consumers, in the end will be faced with some kind of later from either supply disruption or dramatic price increase or a combination of both, most likely both. That's not in our interest.

So my thesis was what's happening is that you are driving the market away, you are holding a price above what can maintained in the market and you really should be thinking about permitting the price to follow more closely what the spot market and the futures market seem to be telling you. People are willing to pay for oil.

There's another factor that has occurred that has been concerning us. You look back historically when the price of oil had been maintained very low for a good number of years down around $3 a barrel or less, you all are aware that the consumption pattern was up. When the price went up dramatically in 1973, the consumption pattern actually dropped for a couple of years and then resumed. As the price stabilized through the middle '70's and toward the end of the '70's, the consumption pattern went back up again and the United States actually peaked its highest consumption ever, I believe in 1978, nearly 19 million barrels a day, 18 and a half, 19 million barrels a day.

When the price went to $34, of course the world consumption of oil began to drop dramatically and it kept going. I think that it was accelerating at $34 a barrel and the reason it was accelerating is people at first only had a certain amount of flexibility in their purchase of oil.

As the price persisted, as they build into their system, structural changes, what I see happening is they were beginning to be able to accelerate this speed with which they were leaving oil as a source of energy. Finally, the price pressure occurred and the price dropped to $29 a barrel.

Now the figures I've seen suggest that when the price dropped to $29 a barrel, world oil consumption started back up. It continued for awhile and then it began to peak and it's now overall on the way down, although the United States is continuing to freeze its consumption. Now we've got a chicken and an egg problem, some saying, yes, that the economy of the United States has been going up therefore the consumption of oil is going up, yes.

There's another argument that the price of oil has come down in the United States, therefore the economy is going up and it's probably a centergistic (phonetically) process. I'm not proposing to tell you how that all relates to each other. But what we have seen happening is since March of 1983, the price of oil in the United States has dropped by about 20 percent. We're down about 20 percent. But there are other countries in the world because of the way the dollar has gone up in value or -- the price has risen by as much as 30 percent or more, especially some of the less developed countries.

And so the industrial arts countries have seen tremendous price increases over the 1983 predrop price. If you look at those numbers you can begin to see why I think, anyway, why I think the -- consumption of oil is starting back down to the rest of the world. There seems to be enough to offset what we're doing.

My thesis in London went on and it said, "Therefore if you're a producing nation and you hold the price at 29 and you can see the consumption curve dropping and you don't do something to meet it, if you finally decide to do something to drop your price to bring your consumption back, you may find your customers have found another way of supplying their requirements."

If you look at the cost of alternative sources, you're dealing with things like geo thermal, hydroelectricity, solar. Once somebody has installed the unit he's got his capital in it, the cost of production is next to zero even if you count on that expense.

If you build a nuclear power plant, the cost of operating is fairly small, at least if we're successful in the Department of Energy, keeping the price of enriched uranium at a reasonable price. If you've got coal you can see an increase in the price projected but it's dramatic with the volume of coal that's available in this country and the availability of it.

We look at natural gas and now this becomes certainly more questionable. Industrial gas but some of the forecasts look like that. The oil prices are on that kind of a curve over the long haul which is what we look at. What you see happening is that once installations have occurred with these resources in the United States or other consuming countries, the price of oil has to come along way down before somebody will consider shutting down any of those resources in order to build a facility that will use oil and then substitute oil for it.

If I were sitting as some countries are on vast pools of oil, I would be very concerned about the long term effect on my ability to pump out and sell at a reasonable price. That was, if I can say, I think pretty much the thesis that I set forth and I did say in the speech that the deposit of the long range forecast that we were looking on the price of oil from this time forward was somewhere in the range of $25 to $30 a barrel. This is $30-$25, the price is here today although that's the market price. They actually have different figures for future markets and the like.

What I did say in London is that it seemed to me by the consumption curve we're looking at is very hard to see that the price could stay much above the lower end of this range and that's where you see headlines about $25 a barrel.

There's one other thing I need to mention in this regard that is that we have another language problem. In talking with OPEC ministers it's apparent that they feel $29 is the real price. That's the real value/price for oil. When I talk about a lower price, they see me as attempting to drive the price down to an artificially low level.

I see the market as dictating the real price and when you hold it at $29 when the market is saying something less than appropriate that's an artificially low price. We agreed that we have at least a semantic difference on that point.

I spoke yesterday to a group of reporters and I stated that it is not my intention to try to drive the price down. It is my intention to try to open the price to market response. I think in the long run that will provide stability.

I've got to alert you in case you see something to the contrary, one of the wire services -- has the following statement he, (that's Hodel) said the OPEC view is that $29 per barrel is a proper price but that he is "trying to drive the price down" to a lower level. This would make a good sentence to put in an English course on the clarity of meaning.

I think Maguire meant (a) he said the OPEC view is (a) the $29 per barrel is the proper price and that (b) Hodel is trying to drive the price down to a lower level. That's the OPEC view.

I think that's a correct statement of the OPEC view. The second half of it is not a correct statement of my view although I'm inclined to agree. I just wanted to make the point in case you read it, don't walk away from here saying, well, he's not 100 percent bad and then pick up that article and say he's 120 percent bad.

I think you can see this just as well if the lights were just a little higher. Is that possible that we can put them up just a little bit? It also gives me a chance to see if there's anybody left. I'm always reminded of the story of the fellow who got up and he read a speech, a two hour long speech, Bob. He stood here and just read it. When he looked up when he was finished there was one fellow sitting in the front row. Everybody else was gone. He looked down and said, gee, I really appreciate that you stuck around this long and the guy said, that's all right. I'm the next speaker.

The other item I want to cover before we talk about another item is the budget. You've heard a lot about what the budget proposals are. Many of the documents that have been talked about have been distributed or have been seen by people throughout the country.

The fact is that the President is committed to not raising taxes. He is committed also to reducing that budget deficit. It is for Randus (phonetically). He can stay on the present course.

On the tax raising side he is firmly convinced and I agree with him totally and it's not just because he is my boss. I would say this even I weren't in this job that if he raised taxes Congress will spend the money and will not be able to reduce deficits and history is on the President's side on that issue.

Therefore, there are only two ways you can reduce the deficit, one is to increase revenues by the growth of the economy. That is one of our strategies is that we should have growth without inflation in the economy. And secondly by cutting Federal spending.

In order to cut Federal spending it is imperative that we go after what some would call sacred cows, others call Washington monuments, others call fish hatcheries. I say fish hatcheries because when I was with the Department of Interior, one of the techniques the Department of Interior could always use to satisfy the Owen meat cut requirements is to offer up some fish hatcheries.

Now you did that because you said, look we cut $4 million out of our budget like you wanted knowing full well that when it went to Congress, Congress would put fish hatcheries back. Every department has its fish hatcheries. In fact I think there are more fish hatcheries in the Department of Energy than in most.

I kiddingly say I thought I used to know what the pork barrel was when I was at the Department of Interior. When I came to the Department of Energy I found out what it really was because we have a project in some of these Congressional districts all over America. I don't care how fiscally conservative you're going to be, the Senator has real sensitivities if you try to cut into the operations in his own district. That's only realistic. That's the way it has to be. That's how this system works.

The fact is we've got to reckon with it and try to deal with the budget deficits. There are those of us who believe and I know the President believes this and I think the cabinet believes it that if we do not approach the budget deficit on a comprehensive basis we won't be successful.

We need to go after the budget problem so that when I go the Hill and ask to cut fish hatcheries whatever they may be -- when I go up there and say I want to reduce the amount of money we're spending in this area. I want to cut it out. That I will not be faced with the Congressman or the Senator saying why you, when nobody else is doing likewise. I've got to be part of the comprehensive process.

If you look at some of the things that are proposed, that certainly is how it works. I think you probably read and currently what we're reviewing is freezing at the 1985 inactive level plus additional cuts in the Department of Energy budget. The figure we're talking about is 10 percent cuts pretty much across that array of research that we were talking about, pretty much across that whole array. That will have an impact, I think, marginally on some of the activities here but certainly more intensively on certain other categories of the energy picture.

The particular item I wanted to mention to you that specifically relates to not only your industry but to some of the studies that you have noted that you have under way is the strategic petroleum reserve. The strategic petroleum reserve today is at or just slightly over 445 million barrels.

The point I keep making is that Mexico is our largest supplier. I think this month or this year United Kingdom has been our next largest. Canada is in fourth place. Saudi Arabia is in third but very close, the UK, Saudi Arabia, Venezuela, Indonesia, they are all fairly close in their supply to the United States.

The point is being the Persian Gulf which is the area we look to as perhaps the most vulnerable -- volatile, vulnerable at the present time is a relatively small share of domestic imports. So we're looking at 445 million barrels and 98 days supply. When we started out to build the strategic reserve, it was thought that we would seek, I think, a 90 day protection against crude interruption in the supply because we only take crude and that's running under 3.3 million barrels a day at the present time.

If we only take crude today, of course, if you can divide this in quickly, I think you're going to find it's approaching 150 days supply of just crude. We look at the end of 1985, fiscal year 1985. That's September 30th. By that time we'll have approximately 500 million barrels in the strategic petroleum reserve. I think you take -- the number we use is 489 million barrels estimate in a months budget is something of the price of oil and the like. It could be somewhere between that 500 million, close to 500 million barrels not different, incidentally, from one of the original targets that was talked about.

Another target that was talked originally was the billion barrel. At the time the billion barrel was talked about it was thought a billion barrels would be necessary to provide us with 90 days protection against the projected level of imports. We don't see imports going that well in this country and therefore it seems to us that the opportunity exists to reduce from the billion barrel level down to a moratorium level in 500 million barrels.

I would suggest we would not go forward with the big Hill site at the present time. Obviously, future import levels could effect that but for the present time we don't see that happen.

One of the rationals not only is the budget aspect which purchasing 50 to 60 million barrels a year, you can calculate the cost of money, carrying costs and all that. It's very valuable. I use the figure in my own head when I'm talking about this strategic petroleum reserve that's costing the United States between $3 and $4 billion a year. Some of that's off budget, you know. People say it's off budget.

That's off budget is if your wife goes into your wallet and takes the money out of it and then spends it, that's off budget. You're still going to notice it's gone. You keep a reasonable, careful account. Maybe your son is a better examiner. If my wife wanted to do that then she runs our finances. It's if I go into my wife's wallet and spend it without telling her.

So there's a budget issue. Then we are members, as you know, of the International Energy Agency. International Energy Agency targeted initially 90 days protection. That was the target we all set out. We were going to build strategic reserves so that we can not only do disruptions supply, we'd be able to meet our requirements for 90 days.

Now some of the IEA countries are below that, some are quite a ways below that, some are fairly close to it depending on how you count and I won't go into arguments about whether they're counting right or not but there is an argument to be made if some of the counting is the question.

If you're in an insurance consortium with somebody as we are, IEA is in a sense an insurance consortium against the interruption of supply. If you're in an insurance consortium and your target is 90 days of protection, when you hit 90 days if you stop it, if you continue to increase so that you have 110, 120 or 130 days supply protection for yourself and you're only one third of the protection that's sought which is the case in this instance then you have made two thirds of the day's contribution to your friends for every additional day that you have here at strategic reserve.

The question is, at a time of tremendous budget crunch, does the United States of America have the money to spend on an extra additional insurance over what the target was when our allies have not been level to begin with. Our argument is no. We shouldn't be doing that either.

So it seems to me there are a combination of reasons that we can set forth if we're going to take as tough a stand on the budget as we think we have today. So much for strategic petroleum reserve.

The last item, taxes. First of all I've got to say that Donald Regan and I have this little deal. He doesn't make energy policy and I don't make tax policy. Now there is a tax policy that you can make that will have an effect on energy policy.

It seems to me the obligation that I have to the President and Don Regan to be a spokesman for how I see, how you see the proposals for the taxes effecting the energy and effecting our national goal on the national policy on energy.

First of all let me raid one of my visual aides here. This is the summary overview of the tax reform for fairness, simplicity and economic growth. I'm not here to argue with you over each of those words which I think having talked with some of you last night you'd be prepared to do.

What I want to illustrate is that this overview itself is a fairly thick and substantial document. The Treasury Department could not conceivably look at every possible impact of that activity. What it did in this industry is it took an overview. It took some involved numbers, it made some assessments and evaluations of what the effect would be and then came up on a plan based not on that outcome but based on what its perception was of what a fair, flat tax would be eliminating inappropriate incentives, eliminating inappropriate obstacles in life.

In so doing, I understand clearly that there are those of you who believe that there's a substantial impact which I don't pretend to know all of the ramifications of it. What I'm seeking to do is to become sufficiently converse with an impact on energy that I can describe effectively to the President what the issue is.

Now let me say something else. You get mixed readings from people as to how far they think this tax proposal will go. Probably the majority of the people today say, oh, that tax proposal won't go anywhere. That may or may not be the case. I don't think that's the issue because there will be something that follows behind it.

If when something follows behind it, we have not clearly presented what the effect of this proposal is on energy. Then when the next proposal comes along the people putting that one together will say, well, gee, nobody complained about the energy effect of the first package. So we can appropriate those as they were.

I submit there's a reason for me to be concerned and for you to be concerned regardless of whether this particular package goes through or not. What I need to be able to do in a very short period of time is to express succinctly at the Presidential level, at the cabinet level, the effect on our energy policy and on our energy industry of these kinds of tax proposals.

We've attempted to take a quick look at what some of these effects would be and let me say that really it is a quick look because first of all we don't have the expertise that it would take for this group. Secondly, we have to work with a lot of assumptions as you will also but they're not the assumptions necessarily that you make.

So we took a look which basically looked at these issues. Now maybe I can improve the focus by sliding that a little further. Now you can't see it. What we have is the two categories that is independents and majors. Then we took a look at what the value of oil was. We looked at two scenarios one is oil that's already producing and oil in the ground before the well produces.

We looked at the value under current tax law and then we eliminated the percentage completion allowance which, of course, has a negative for the independence on the value. Then we eliminated the expense of IDC's. Now on a producing well it didn't have any impact. So it's zero impact on a producing well. Then we introduced the cost of completion index in which was a plus. We accelerated the windfall profit tax reduction which was a further plus but because it doesn't begin until 1988 and you can use any kind of a decent discount rate. It doesn't have a very significant effect. It's a small plus.

Then you reduce the corporate tax rate which in fact is a very substantial plus on a producing well in our calculations. This will have tremendous variations depending upon how rapidly you deplete the well and what the costs were, whether it's onshore or offshore, what the price assumptions you make are, the pricing of it. If the price is flat -- incidentally in our assumption we assume that the price of oil in real terms stayed stable. This is the depth of research we've been able to do on this. We need -- on this.

Those kinds of figures what we found on a producing well is that the reduction in corporate tax rate more than offset the negative effect on these other reductions for both independents and majors.

When we look at that same well before it was found, when it was in the not yet discovered stage, however, we found very little effect from the majors. But we're into this kind of calculation and we found that for an independent there was a substantial reduction in the value of that oil in the ground approaching 50 percent. What its value is, under the current law, is one number and this number then about bottom value under the Regan tax proposal. I want to emphasize that says Regan not Reagan.

Under the Regan tax proposal was about half, not quite but just about half which many people would say and I think I would understand why they would say it would be a substantial deterrent to investment in exploration and development by independents. There are further factors that need to be taken into account which we haven't plugged in. I think partly because we don't know how to plug them in.

What I will run into -- just let me try to set the scene for you. I am trying to argue about the effect on energy policy of a tax proposal like this. When I open my mouth those who are supporting the tax proposal are going to be prepared to shove all of my words back down my throat. The first question I will get will be something I haven't covered and they will say something like, yes, but when you look at the effect of dividend deductions, the effect on shareholders more than offsets all this stuff you've talked about.

Now they may be true for -- companies. Many independents are not. I don't how many. I don't know what the figures are but certainly somehow you have to plug that in to the fact that you have to lower personal income tax rates. The corporation that pays dividends is free to under the tax proposal to drop 50 percent of dividend payments. It would seem to me the impulse of that would be to pay dividends rather explore for oil. But I don't know if that's true. You have to plug those in.

Then finally we've tried to say, okay, what are the overall effects of all of these things put together. I managed to snap myself apart there. All of things put together with the overall effect that all of these things put together on the investment decisions that people will make when it comes to gas and oil.

What we would appreciate very, very much -- what I really need if I'm going to do a halfway decent job of representing the energy concerns and particularly in this case, the National Petroleum Council made up of parts of oil and gas people, if I'm going to represent effectively your concerns, I'm going to need to have some information that I can use.

What we've done in this analysis that we've done so far is really to take a tiny, tiny slice, a tiny, tiny, snapshot of a very big picture. What we need to be able to do is figure out how I can present in three minutes or five minutes or ten minutes if I can get that much time what the impacts are in energy.

Further, greater detail is available for us in our discussions with Treasury. We're in regular weekly meetings now with the Department of Treasury about impacts. We're not well equipped in all candor at this point to carry the case the way it ought to be carried.

What I'd like to do if I may, Mr. Chairman, is ask that I would turn this machine off and I would like to have the lights come back up and then I'd like to sit down and I would very much appreciate it with your permission, sir, that we hear from people here. I will take notes. I've got so many staff here that if something happens to the Department of Energy today there's nobody there to do anything about it -- who will be listening with great interest to try to get your comments, your impressions and the like.

By the way, if any of you are nervous about this whole process, let me say I checked with the White House before I propose doing this. I was told the President can be serious about seeking comments on this proposal. This is the Treasury's proposal. It's been very carefully stated throughout. We want the best advice we can get on how we should approach this from an energy standpoint.

CHAIRMAN MOSBACHER: Thank you, Mr. Secretary, for those interesting, profitable, provocative comments.

I think am I correct in that besides the oral comments today that you would be interested in any written comments, is that correct sir?

SECRETARY HODEL: Yes that is, that's right. In fact, if one of the reasons -- is this on?

MR. NICHOLS: The other mike is.

SECRETARY HODEL: One of the reasons I showed that particular chart is that I wanted you to see the kind of analysis we ran. That doesn't mean that's the right analysis but if you'd run those kinds of analyses any kinds of numbers you could give us that would fit into that would prevent us to do a broader spread sheet or array of different looks, but it tremendously sensitive.

Whatever you do it is tremendously sensitive to the assumptions about the rate of depletion and so forth. So we'd be interested in that. We need to know the assumptions when we see those numbers.

CHAIRMAN MOSBACHER: Okay, thank you.

Those who would like to send them perhaps as soon as possible in as much detail and information and statistics as possible to back the thoughts, pro or con, whatever they might be.

SECRETARY HODEL: Right. Pro or Con.

CHAIRMAN MOSBACHER: And now we'll start the arguments and discussions. Bob Parker has his hand up.

MR. PARKER: Mr. Secretary, I'm going to try to -- only the one impact that I have been able to determine to have on activities within the United States upon exploration for oil, and I would base my comments not only on what I feel but on what the 12 major companies that I've spoken to and the 25 independents and I'm dealing with just one subject.

We have a whole shopping list and I'm sure there will be -- other than that. I'll deal with those. Since we drilled for other than the crude, nine out of ten holes we drilled are dry and everyone in this room knows that before they spoke yet the -- we got and that means risk beyond any other business in the United States is higher with risk money whether it's our money or someone else's money.

It is risk money and so categorized and that makes it different because we risk each other's and each of our customers. According to those that I surveyed none of the majors had done their homework yet. All of those were in the process of doing so.

None of them don't think it would increase programs. All of the independents felt that they would decrease their program as much as 50 percent. When I asked them about their homework most of them said it was none of my business and I can just inform you that they indicated immediate cutback.

This same question yesterday at New York with a New York security analyst, which are those that I think provide a very worthwhile service, even though wording of this tax proposal infers there is something improper about outside funds coming into the search for natural gas.

I don't agree with that and I, with those who were over in New York yesterday and they spoke about 14 current projects that have been suspended for drilling activities in the United States as a result of the proposal -- and then seven more that were mailed out last week, which -- imposed, that -- recalled if the proposal were passed. I'm holding evidence in the -- there is no doubt it. Risk is going to be involved and doubt about the negative effect of risk running -- through their region.

Finally, the -- had according to them and I believe in my brief that was the result of increased input on immediately. The premium price of the increase was priced well beyond the $25 or $29 dollars. It's sometimes known to double the loss of jobs.

CHAIRMAN MOSBACHER: Thank you.

We can stay over in this quadrant to start with. George Mitchell?

MR. MITCHELL: Mr. Secretary, I'll be making a brief statement --. I want to go back to the basic sense of the really disturbed business conditions have been on policy on oil and gas.

I think we all agree the last two or three years we are underdrilling this country the finest -- of gas reserve -- the enormous amount of inputs going on.

We're up to 5.5 million barrels a day of oil in products of this kind. I predict that in four years that it will be up to 6 and a half to 7 billion barrels a day. Yet I think that we are overdoing doing real estate structures and things like that and --.

We must have a policy that allows the development of oil and gas reserves because the only hope, I think, we do have to be self-sufficient has taken us 15 years to start production. We had to expand the rules on 6,000 wells -- if we started today it would probably take over 125,000 -- to really get down where gas -- was maybe 5 million barrels of oil in 15 years. And there's not been sentiment there to do it under the present law.

Now, unless this law that we had proposed would rededicate a great deal of funds back into the independent, they drill about 85 to 90 percent of the wells, I feel that this would be quite a really shortfall of what we must do because when we talk about a $55 billion dollar balance payment deficit this year and maybe an $80 billion dollar balanced payment deficit in four or five years, I just don't think this -- 44 percent is spent on foreign oil. I don't think it's initiative is taking -- therefore, I think we must examine this very closely.

CHAIRMAN MOSBACHER: Frank Pitts?

MR. PITTS: I have made some notes that I'd like to read. Mr. Secretary, if passed, in my opinion, the so-called simplified tax plan will force thousands of independent producers out of the active business of drilling new wells. The offset is already starting.

Reduce the amount of new wells drilled by 30 to 40 percent. Reduce the amounts of new reserve of oil and natural found by 30 to 40 percent. Significantly increase the nation's dependence on foreign oil and natural gas. Weaken our national security. Increase our nation's trade balance, which this year -- the trade deficit, I mean. Looks as if it were 100 billion dollars this year, escalating from what 68 or 69 billion last year.

Reduce -- and here is a very important point. Reduce tax revenues available to the U.S. Treasury, cause thousands of Americans to lose their jobs. To put it mildly, I'm very much against --and as a result I am mailing at my own expense over 10,000 letters today and tomorrow to independent producers all over this country, asking them to let the President know their ideas of this so-called simplified tax bill as it relates to oil and natural gas.

CHAIRMAN MOSBACHER: Dave True?

MR. TRUE: Mr. Secretary, I'd like to add a kind of a personal note to this if I might. I've made my livelihood from the petroleum industry for over 50 years, The last 37 of which have been as an independent, unincorporated, in Casper, Wyoming.

For the last 30 years I've had the opportunity to come to Washington D.C. and testify on facts and other matters before committees, agencies and departments. Over the years, looking back, I've testified, ouch, you're hurting me, you're my industry and you're hurting my country.

This has been going on for awhile so this is not fair play. If it hurts me then it hurts my industry and it hurts my country. So, we have spent ten days reviewing the overview of the Secretary of the Treasury's proposal.

Now, we can see only one result that evolves into two options. We can take the results of our 37 years who have been in business and gradually liquidate it. Why produce any oil we've got in the ground. And maybe we would pay less in personal tax, as you pointed out. The value of that oil would be depreciated overnight.

Or secondly, when you do -- the over 37 years, that is selling out. If you could find somebody who wants to but it but the bottom line is I can see no way in the future that it would drill a single exploratory well or even a rescue --.

CHAIRMAN MOSBACHER: Thank you.

John Rex Jones?

MR. JONES: Mr. Secretary, Mr. Chairman. We at the IPAA have been talking with the Department of Energy and -- McFarlane and with Secretary Clark about energy security for America. We've decided that we've been talking with the wrong people about energy policies in the United States.

Secretary Regan has said that this proposal will not impact adversely to majors or the large independents. After talking with some of our many friends here we can't agree with that statement but he has said that it will impact most adversely the medium-sized independents and the small wildcatters in America.

He said that this proposal would make our country more dependent on foreign sources of energy. He admitted that in his proposal. We maintained that that is the understatement of the year, Mr. Chairman, and we do hope to respond and shall respond with graphs and figures to support our position.

Just one quick example is this. This is the drilling chart for last years' rig count and this years' rig count. You will see that last summer we had 400 more rigs running in the United States then we did in 1983 for the corresponding month. That's the middle part of the chart.

Then as prices for oil and gas softened we saw the trend line flatten and then we saw the trend line at the end of the chart, two weeks ago, actually cross. So that if you continue that trend line on into the normal spring decline you will find that right here at that bottom part that we usually have in April, in 1985, our rig count will be below 1800 rigs in the United States, which will be 40 percent of our available rig fleet and this is without any negative impact of the tax proposal our projections were.

So you can see that we have a challenge before us. Now we've had challenges before us before as an industry, natural gas deregulation, and we worked together in spite of a lot of heat from members of our association. We stood with the administration and we stood with the industry on total deregulation.

Now we have a new challenge, this proposal, and we maintain that we again will stand together as an industry on something that is so adversely going to affect our nation, our nation's security for energy and our industry as a whole.

Thank you.

CHAIRMAN MOSBACHER: Thank you. Richard Gonzalez.

MR. GONZALEZ: Mr. Secretary, I'm an economist, formerly with the Humble Oil and Refining Company as their chief economist and director in charge of economics, corporate planning and finance. I've testified extensively before congressional committees about taxation of the petroleum industry and I am concerned about the fundamental thrust of economic growth of this country, which to me is the paramount consideration overriding the questions of simplicity and the question of fairness which is in the eyes of the beholder.

Now, my judgment -- let me say that I'm now a senior research fellow with the Institute for Constructive Capitalism of the University of Texas. And we co-sponsored with Resources for the Future a conference here in Washington at the Brooking Institution last June on the topic, Improving U.S. Energy Security.

To me, that is another fundamental consideration that the administration has realized is important to the nation, because we are literally spending billions of dollars and it is costing us on strategic petroleum reserves and it is costing us billions of dollars in terms of adverse trade balance to import oil.

And this is because of mistakes that we have made in the past by the federal government of keeping oil and gas prices below their true market value.

Let me introduce a concept that was used in our conference of the equilibrium value of oil and gas in relation to coal, which is an abundant energy resource. And what the government did for years was to keep oil and gas price below the equilibrium price of coal and force people to shift to oil and gas, which is a scarce resource.

Then the prices came about into equilibrium between '74 and '78. And then they got out of equilibrium again because of our mistake in making OPEC think that our only alternative was synthetic fuels. And in his message to congress, President

Carter said that we would have to subsidize synthetic fuels until the price got to $28 a barrel.

Immediately, the price went to $28 a barrel and then it went up on the theory that it should keep pace with inflation. Well, that got it completely out of line with the price of coal and it encouraged people to invest money in switching out of oil into coal. But we now have the situation in which if the price of oil drops sharply, it will again start displacing coal.

And again we will begin importing oil when we should be producing our own domestic energy resources. I can say this with assurance about the proposed tax reform. It is based on an erroneous economic theory and it will go counter to improving U.S energy security.

The theory that it is based on is that an income tax uniformly applied is neutral in its economic effect.

At my suggestion, the Brookings Institute years ago published a study on this very subject which shows that an income tax uniformly applied is not neutral on an industry that is risky and capital intensive.

Now both of those things require a higher than normal rate of return. The petroleum industry is a classic case of a high risk, capital intensive industry. Therefore, a corporate income tax on it is not neutral and it will penalize the users of oil and gas if it is applied in a neutral way.

That's why congress, years ago, when income tax rates where very low, decided that percentage depletion was necessary in order to assure reasonable supplies of energy for this country. And the system worked until we started eroding it by changing percentage depletion and by imposing price controls on oil and gas.

Now the administration, fortunately, has moved very effectively toward removing price controls and I think the only remaining step is to get rid of them on natural gas. But the important thing is to realize that regardless of how we weigh the impact on past development and reserves, we've got to focus on what is the effect on future development and reserves.

Because if we do not increase the rate of development and use of our own domestic resources, we are going to become more dependent on imported oil. And that's going to be terribly expensive to the nation. This industry produces both oil and gas. We produce more energy in the form of gas than oil. We cannot import cheap gas from foreign countries other than Canada and Mexico, and they're not going to sell it below what it is worth.

Now when we take those two forms of energy into consideration, our domestic energy is cheaper than foreign energy.

And we should be considering the imposition of a national security tax on all oil imports, starting at four cents a barrel in 1985 or 1986, and increasing by four cents a barrel each year thereafter until it reaches twenty cents a barrel or until imports drop to fifteen percent of our domestic consumption, which is about where they were in 1954 when the government first became concerned about imports.

And the President appointed a committee on national energy resources. And it's recommendation at that time was that imports should not be allowed to increase their share in the U.S. market. We did not follow that recommendation and it got us into trouble. Now this is a very crucial thing, and one of the most important things the administration can do is make it clear that the changes that are being talked about would not be effective in 1985.

It's very clear. The document says none of these changes would take effect before January 1, 1986. So it's terribly important for investors to understand that you're not talking about effecting their decisions in 1985, and they will have plenty of notice whether they are going to change them in 1986.

Now, for God's sakes, I think we should not make any change that would in any way run counter to the fundamental incentives to improve U.S. energy security.

CHAIRMAN MOSBACHER: Cliff Trice.

MR. TRICE: Mr. Secretary, Bob. This may be coming from the best part of the country. These figures and statistics are most important. But, Mr. Secretary, I would urge you, as you and your staff articulate the -- price requirements, the fact that we as members of this industry are concerned citizens. We're not all fat cats. We're not all selfish. We are concerned.

As my brother George Mitchell says, he's drilled 6,000 wells. I've been in this category about 3,000 wells. I've been in the business since I was 11 years of age. And, as I say, I don't know anything about it.

And I would suggest to you that in the last 35 years we caused some 3,000 wells to be drilled and the better part of those funds comes, exploratory dollars, comes from outside investment. Wells will not be drilled, exploratory wells will not be drilled, at least 85 percent of exploratory wells will not be drilled from outside because we will not have those funds.

And we, like my good friend David True says, we could help you -- find gas in the ground. We may start seeking elsewhere to invest our money, rather than drill our own -- spend our money in the industry. We are concerned. Statistics and data are important. Psychology only builds a barrier with a great mass of people, that we're selfish, we're fat cats. May I suggest to you, I think I'm overdrawn at the bank today.

CHAIRMAN MOSBACHER: Anybody else on this side of the room? Jim Glanville, Investment Bankers perspective.

MR. GLANVILLE: Thank you, Bob. I think that I can't really add a great deal to what our friends here have already said, but I would like to make or two quick points.

I think that this is one of the situations where there has been too much rhetoric. I think the very definition of the proposal as an attempt to make taxes fair has to start out with being a introduction to rhetoric which serves no useful purpose.

There have been equally rhetorical statements made from the other side. I saw an editorial which was described as a plan to de-industrialize America. I think we have to look at this, not from the perspective of your taxes or my taxes, but what it does to the whole country.

And I think that the Treasury proposals -- and I was pleased to hear from the Secretary that they had been well-considered, I was somewhat disappointed in reading their rhetoric or their analysis and I would just use one word, one sentence. Investment in oil and gas is tax favored. Capital has been diverted to other more productive economic activities. No basis for it, that's just a given.

I think when you start to devise a tax system with that type of understanding of the business, you inevitably run into the chance of substantial difficulties. The Treasury has also just completely written off the mining industry, which is a sister industry to us.

Under their analysis, their proposal on mining, they say because the expectancy of excess capacity which currently exists in the hard metal industry, the proposal will have minimal effect. Well, we all know that there is a very long lead time in development of mineral prospects, mineral projects.

If we propose to turn our acquisition of resources over to unstable parts of the world, then we deserve whatever happens to us.

On the question of fairness, I'd like to go back to Russell Long, to his -- he's been my advisor in this area for many years and he's probably heard more people blathering about fairness of taxes than anyone else in the world. He says fairness is, "Don't tax me. Don't tax you. Tax that fellow under the tree."

I think that it is clear that we can't -- of course this is not a fair proposal in my judgment. I've also tried, Bob, to look at what would be the short term effects of some of these things. One man's loophole is another man's incentive. We have to avoid the question of subsidies.

But I have, for this purpose, just taken a disincentive number of $1 billion a year. What does that do? Everyone can then make, whether they think the disincentive is $10 billion or zero, they can then subtract the numbers.

But if you take $1 billion and make some assumptions about the cost of an average rig, you certainly are going to reduce the rig count 3 to 500. Just for $1 billion. And if it's more than that, the rig count comes on down.

Second, $1 billion at the industry average finding costs produces something like 80 odd million barrels of reserves. Using a normal zone of reserves, this will not be discovered. Using a normal decline curve, that would increase imports something in the order of magnitude of $400 billion a year, increasing from that point forward.

The rigs which are shut down, the effect on the service companies, will have a major impact on unemployment. And we're not just talking about rig crews being shut down, but all the industry which serves the rigs. And that includes the people who run the local cafes and what have you.

The impact on the industry and the area will be, I believe, substantially more negative than is perceived by the Treasury proposal.

One last point I would make, and I'm sure this wasn't the intent but if it were drafted in such a way as to divide an industry, I can't think of a better way to have done it. When one analyzes this thing, if you analyze it in totality, you may lose here but you pick up there.

And I would use a specific example, the dividend deduction. Our friends over there tell me that's the least likely thing to happen. It has almost no chance of passing. Yet, for certain members of the industry, it can become an important -- have an important impact on their analysis of the whole picture.

So I think if we're to learn from history, what generally happens from reform is all the bad things get in and very few of the good things.

So I think it is important that we look at the impact of this proposal and on a realistic basis, make a realistic assessment of what will be passed. Thank you, Bob.

CHAIRMAN MOSBACHER: Thank you.

Fred Hartley.

MR. HARTLEY: Well, some people say I'm too independent to be a major and too major to be an independent, but we all live in the same ocean.

I recall the debates that went on at the time the depletion question was discussed and was forced onto the majors and was still available to the independents.

Well, it's quite obvious the independents and the majors didn't die. In fact, they got so damn virile, they're running around killing each other. And what really happens in this situation is, in the first place, we businessmen don't pay any of these taxes. They've got to end up being paid by our customers. Any changes that occur, ultimately, water is going to seek its level and we're going to have to stay alive with whatever the environment for doing business is.

And my main concern in this whole situation is whether you're really going to go full circle on this doctrine of fairness. Obviously, I'm as upset as anybody else is.

It takes a responsible attitude to our society with the debts gotten totally out of control and our balance of payments is unbelievable and the country has a former capitalistic greatness. It's kind of falling apart. And this, apparently at this point in time, the Republicans have seen fit to adopt some of the platform of the other party.

Even the use of the word "fairness" has suddenly changed from camp A to camp B.

SECRETARY HODEL: Fred, just to keep the record straight, it ain't the Republicans, it's the Department of the Treasury.

MR. HARTLEY: Oh, I love the way you compartmentalize your brains. Al respects that. Very few of us have that ability, I might add.

For example, I was shocked to find out that General Electric makes $2 billion a year and pays no taxes. Well, I found out the other day why, the real punch line. They came roaring to our people to say, "Look, we'll put you in a cogeneration power plant at your family refinery. It won't cost you a cent, because we've got some "sucker" rules written here in our tax laws which allow us to get all of the incentive tax credits, which allow us to get class depreciation.

It's so good that we're going to give you all the steam you want for this operation. It's going to be a cogeneration deal. And, of course, they use their credit facility to bring all that about.

And here's an outfit that a good portion of their business depends upon their defense contracts. They build all the engines for the new B1-B, for example.

They don't pay taxes. Well, what does that mean? That means I'm paying a hell of a lot more than I should be. So, obviously that's a very prime example of what the Secretary of the Treasury is driving at. There isn't any fairness. And these tax laws are being used to gimmick up our investment decisions.

So rather than making decisions on a quality investment basis, the decisions are made on a quality of tax evasion basis. The elimination of taxes. That does not seem to me to be a very sound basis for a virile leadership democracy in this world.

But to come to the full circle concept, Mr. Secretary, if we're going to do what you propose, what the Secretary of the Treasury has proposed, we've got to follow through in total. We can't stop by eliminating incentives that we say we have today which basically are in two categories, the immediate write off of intangibles, and for the independents, the use of depletion.

I might point out to Mr. Parker, who is going to insist on drilling nine dry holes out of ten, depletion doesn't mean a damn thing to you.

It's really a fast turnover -- it's the fast turnover of the intangibles is really the important thing and, of course, all of the aspects of leveraged capital that we play with in this country with great, great skill. I get deals all of the time telling me Hartley give us $50,000.

If you give it all back in two years it won't cost you a dime and the taxpayers in the United States will be glad to give it to you. Propositions come forth like mad.

The question then is, are you going to follow through and put in the position of free market so that we can get the price corrections to go with the regulation changes. To be specific, we had a gas contract on the West Coast for the monopoly, not a free market. OPEC doesn't know what a monopoly hold price fixing organization is until you've ran into the West Coast Gas Company.

They just added 20 cents the first of the year. If you don't like gas at your price, Mr. Hodel, the regulated priced of $3.82. They said we're not going to that any more because we've been sitting around with those Canadians. Those Canadians want to market it so they're going to give it to us for $3.20. So the hell with your gas.

Now this is in spite of the fact that we've got a contract. Then the bottom line was well, on the other hand, if you'd like to sell it to us for $3.07, we'll take it. Big deal.

We've got to free -- we've got to take the power away from the State Public Utility Commission so the free market can operate in the national gas field. And secondly, the Government let all that old gas get up to the marketplace.

If we're going to have this free, fair, new, emancipated doctrine of taxation we've got to complete the picture on the gas situation and obviously, the same applies to oil. I don't know why it's such a good idea to put the taxes in effect in '86 and do nothing about the price control on oil in '88. It sounds like you're a little out of faith.

I think if you're going to do this do it with fairness. Boy, you're going to hear that word fairness from me until hell freezes over because I believe in that. I believe in that concept.

The second point is is that if the marketplace works we can work with any rules you give us. Obviously, we reduced the amount of bonuses we paid for this offshore acreage when we lost the -- water had to seek its own level. We didn't have the cash so we couldn't give it to you.

MR. HARTLEY: The other problem we've got today is that we are inundating on our shores, cheap gasoline and diesel from foreign sources that are selling not necessarily below price as they see it because they're in a position to set the price of crude oil anywhere they want to from $3 a barrel on up to $29 because their costs are only $3 a barrel so they can do that.

We're getting it from China. We were getting it from the West Coast, meaning San Francisco. We're getting it from -- we were getting it from Russia. I don't know how much is coming from Russia now. I'm not sure. We dump them out of refineries and -- God knows what price that crude oil is going into those refineries at.

One thing for sure, it's not $29 a barrel and I think this is still the case this past week but if you take the ratio of gasoline and diesel as it's sold and multiply a price by barrels for a totals of 42 gallons, you could actually buy the finished product for less than you could buy the crude oil for.

That obviously means there is not a free market actually, a fair market actually. I saw that -- we -- the reason the producers are now suffering, we're suffering right along with the independents. The fact is -- is that we can't pay you what you should be getting for your oil.

If we've got to compete against these what I call planned economy societies, call them -- call them what you want, they can dictate the price of call them what you want, they can dictate the price of the raw material any time they want to and they are doing it and they're dumping in the raw markets.

So as part of this fairness business, we've got to inact at the same time if we go through with this proposal of the treasurer. We've got to get control of product imports and be certain that they are surveiled and if duty applied to them flexibly as necessary as they decide to dump some of their stuff in our markets.

So that in effect there is a relationship between the price of product and the price of crude oil and without that the -- what's going to happen to our -- our companies in terms of reduction in earnings and reduction in daily explore and so on.

Because of this situation, this situation is a terrifying one versus what's being proposed by the Treasury because that's just going totally wreck the whole situation. I think that that's got -- so I repeat, let's complete the whole circle.

As we go through this fairness deal, you're earnest on paying taxes. Let's be sure we also have a doctrine of fairness on how we Americans compete, the internationalists, many of whom have a strong desire to destroy our society. Thank you.

MR. CARL: Bob, just a brief -- brief summons and then an operator. I'm sure it pointed there it didn't -- the bill until '85 -- Senator -- Bob pointed out Fred was learning --

We cannot lose site of the fact and the bill seems -- the proposal seems that a dry hole whether on producing lease or on a -- wildcat prospect is an economic loss. We must not lose sight of that.

Also the independent -- of one -- incentive that is at the well head. All of the disincentives in this proposal are directed to reduce the profit at the well head. That must not happen.

CHAIRMAN MOSBACHER: Thank you. Car -- Cary Maguire.

MR. MAGUIRE: Mr. Secretary, I am extremely proud of what this administration has done so far and I think that it's very important that it does not do anything that takes away that basic thrust.

I have just two other thoughts I think you might want to consider. Number one is what the effect this would have on the bank industry. Now I'm a director of a bank and I think you lower the value of oil and gas -- is substantial. It would have a significant effect.

I would like to remind you that you had --

bank payers last year and the world -- perhaps the number one problem was our total debt and I think if you caused an accident that helped the banks to increase, preserve the loan losses, you will then have higher interest rates would have an effect on our capital structure.

The second comment I'd like to make is on the stock market. As you know the energy industry represents something like 35 percent of the market. In my opinion you cannot have a healthy market if you do something negative that effects 35 percent. I've invested in the market for many years and I think that it's very important that we had a healthy market over the next four year period of the second term of the Reagan administration if we're going to do the kind of things that we want to do.

And finally I think you can have a simple -- a simpler tax cut or -- and also have incentives for investment. I don't think we have to have this monstrosity we have, so I do support the effort to have something simple but we don't need to take away incentives for investment.

CHAIRMAN MOSBACHER: Thank you. May I hear from this side of the room, please? Jack?

MR. ALLEN: Mr. Chairman, Mr. Secretary, our effort to install a company in the advantage of oil users we will drill about between 25 or more wells per year, sometimes less. We get about 100 different qualities. We have spent time in the last ten days or two weeks analyzing the effect this proposed tax reform would have on our particular business and how it will effect us in the future.

We analyzed it for the years 1982, 1983 and 1984 to date and the bottom line was that while we pay very substantial taxes now, under the new proposal we would pay 116 percent more in taxes. We tried to see what that would do to our business.

We polled our outside investors, our main source we can't poll. Virtually all of them indicated they would not continue to spend at leisure under a situation like that. Most of them are tolerable to tax dollars. She does her own homework on this situation.

We have other sources of -- of capital which include foreign. We don't think we could increase bank debt. The other portions internally generated -- and due to the increase in the level of taxation, our internally generated -- would be going for taxation rather than drilling.

The bottom line of all this is I don't see how we can possibly drill more than 25 percent of the wells we're drilling now. And most of those would be development rather than import our oil. We will be glad to -- you're capable of making figures available to them but I assume we're fairly temptable of the independent sector and if that is the case this can do nothing but tragically reduce drilling in the years to come.

I think that the Treasury has failed to take into account as it's been -- to before. The high risk involved in this nature of our business. We don't foresee -- investing in our business, in a high risk business if you will but if they could reach the same rate of return on the low or small risk venture obviously the Treasury has completely overlooked this.

We're just not going to get the investment capital -- proposals the bottom line is of course let's invest -- oil --

CHAIRMAN MOSBACHER: Thank you. Any other comments on this side of the room? Anyone else? Excuse me. Yes.

MR. LICHTBLAU: I am just looking at the items that you listed before the Secretary and I can see, if you look at all of these items and the negatives and the positives, the net in some cases may not be all that negative. In fact, it could be positive.

If you assume that oil companies as a result of changes -- will spend less money -- substantially less money in exploration. They will have a bigger cash flow and that in turn could increase their earnings temporarily.

But I submit this is a totally irrelevant question. The question is not what will it do to the oil company's earnings but what will it do to the exploration activities. But it's good or bad for the -- us another question and it could be the conflict if they always do to change in tax cost but if you assume it will clearly, as heard this morning here, substantially reduce exploration activities.

If you combine that with your scenario over decline in the price of oil down to $25, it's obvious that there's a very substantial decrease in exploration activities and as a result you must -- in imported oil within a number of years.

To some extent this is already the case in before any of these changes take place but this will clearly accelerate and I think that problem will clear. What it will do this oil company's earnings is the key question on his progress itself. -- see whether this is a positive or a negative proposal for the U.S. economy.

CHAIRMAN MOSBACHER: Thank you. Harold Pruner?

MR. PRUNER: I can't add that much more to what's already been said -- but I will keep my comment free -- and be more consistent.

As a geological engineer with Shell and then a loan officer with -- I've looked at petroleum prospects both from the evaluation side for the company and then from the lender's side from the bank.

This tax bill, I think, is wrong type of proposal because it doesn't match the industry at time of tax. It says the incentives are inappropriate so we -- provide the inappropriate. It's always been recognized that there was a high risk for finding oil and gas that before you drill and find it was expendable and that the product you produced from it is -- and its consequence tax -- were generated over the years to provide what we have as we evaluate a prospect.

We're being asked now maybe to trade. The intended would really cause write-off and certain benefits we get in the analyzing of the proposal for a promise of some greater reduction in the corporate taxes down the road and that won't wash in the industry and in fact it will cause a lot of engineers to turn down or deliver at --

I watched the project -- all the way through tertiary area seven and the -- the loss to the taxpayer takes on tertiary inject becomes a tax.

So it seems to me that this tax bill is untimely and it's unwise and it seems to follow the Washington pattern and never kick a man or in this case the industry unless he's down.

AUDIENCE: Mr. Secretary, one comment. I have seriously questioned the ability of our company to make money in exploration domestically since 1979. -- about the studies and working on this now very seriously for the past five years. We formulated our '85 budget, at least I think, by 75 to 80 percent of our -- abroad.

The tax bill as I understand it will absolutely exclude our corporation from further exploration in the United States. I say the only thing I can add to what's been said here is that I think that our capital investing in the United States in the five years will not been productive. Very,

very -- studying these numbers as we have and probably -- and any production whether it's tangible or whatever really would remove us from --

CHAIRMAN MOSBACHER: Lou --

AUDIENCE: Mr. Chairman and Mr. Secretary, we're pleased to hear your remarks about these were not Republican ideas, they were Treasury ideas. Allan Crownley send an article in the Daily Oklahoma last week in which he made reference to an interview that he had had with Secretary Ragan and -- go over this -- Oklahoma heard from that remark that Secretary Ragan had made of the interview was that the reforms that he was proposing had a short term and a long term effect.

In the short term, the reforms would reduce domestic reduction and would increase our dependence on insecure foreign oil. So that's all right because in the long run the country will be better off. These proposed reforms would be more beneficial because the Capital and Laker released from the energy sector could be more productively used in other industries and the Oklahoma producers heard this. They didn't believe what they said -- what he said that he really meant and if you could convince him to come to Oklahoma and tell us that he didn't really want us to get our of the oil industry, I think you'd be doing some big favors.

MR. ALLEN: It sounds to me like if I could convince him to go to Oklahoma, I could worry about dealing with his successor.

CHAIRMAN MOSBACHER: Thank you.

Well, Mr. Secretary, I think you've heard some comments from the industry. Is there anyone at the head table that would like to make any comments?

MR. MC KINLEY: I might just bother you --

CHAIRMAN MOSBACHER: John McKinley.

MR. MC KINLEY: -- you had suggested that you might like to hear something from an international type company in this activity. We're working very diligently on analyzing this situation. There are a number of factors that you have covered and I won't repeat those but there are many others in this proposal that have very definite negative impacts on U.S. based international companies as we attempt to compete with the non-U.S. foreign activities.

Those are these things on the allocation of interest expense to foreign source income, foreign tax credit, matters of that type. Also, I was quite disturbed to see this thing on tertiary injective expenses. I think in the U.S. we want to do tertiary but this is a very negative in promoting tertiary recovery in the United States which we essentially need to do.

Briefly the status of our work so far in the category of allocation of interest expense, foreign source income, interest expense disallowance, IDC dryhole, tertiary injecting expenses, investment tax credits, all of these things result that the present status of our studies of showing that a on-going business operating around the world will have less cash flows both domestic and international under these proposals. That simply means that we will have less funds to invest both in exploration and in the moderization of equipment.

It also says that U.S. companies that have been somewhat at a significant disadvantage operating internationally are going to be further crippled in that respect under these proposals. We have not finished our work. What we are doing with it now is taking our business plans for the years ahead and running this complete program through what it would do to those business plans since we have about 50 percent of our assets outside the United States and 50 percent inside.

We operate in total in about 150 countries and you can imagine how complex this analysis will be but we're going to finish it very promptly and we'll be pleased to share with you, Mr. Secretary, our views of what this proposal would do to a company of our type.

CHAIRMAN MOSBACHER: Thank you.

Mr. Secretary, you've heard these comments. In summary, I think what you've seen perhaps a small summation by the chair if you'll allow it sir?

SECRETARY HODEL: Sure.

CHAIRMAN MOSBACHER: Regardless as to whether it's good or bad for our pocketbooks, it will undoubtedly diminish the exploration of oil and gas in the United States. If these people who represent frankly the majority of the oil and gas industry in this country are correct and I found them to be correct most of the time, we'll find a strong dimunition in looking for their forfinding additional energy, we will obviously then become more and more dependent on foreign energy and I don't think we need to spell out what that does to the balance of payments, steps of potential as well as national security. Thank you, sir.

Would you like to say a few words.

SECRETARY HODEL: I think Bob is worried about your agenda and running out of time. I apologize but I do think I need to respond. First of all to say, I very much appreciate those of you who have spoken as well as those who have not spoken but who I can tell from various reactions share some of the, especially some of the more pungently stated views of your fellow members.

I have found this session to be tremendously valuable to me and it isn't just the information you've imparted but it is also the sense of concern and spirit with which you've given it to me. I'm sure you may wonder sometimes, well, does it do any good to talk to a bureaucrat? Well, let me tell you, I think it does good. I think you have compounded my understanding and you have certainly increased my will and determination to try to make effectively the points that need to be made about the impact on our energy supply.

The President is convinced that we need to continue to move this nation for energy independence. I frequently use the word non-dependence because independence to many people means no imports. I don't think we say that but independence in the sense that nobody can jeopardize this country by cutting off our supplies. What I hear you saying is Bob has just summarized very effectively is that this bill if enacted as it reads would have a terribly negative effect on that thrust for this country.

I think as Secretary of Energy I've got to be prepared to make that known. I do not believe this nation is desirous at becoming more dependent upon imported oil. I don't this it's more inclined or inclined to become more dependent upon imported products, petroleum products. I understand some of the concerns that have been raised on that as well.

All I can say is that I will try to be an effective spokesman for the composite point of view, not only of this organization but of our own analysis. The analysis which you provide me. It will not just be limited to oil and gas obviously. There are other energy industries. But I conclude, Bob, where I began, we have had a National Petroleum Counsel for many years because we have recognized, as a nation, the tremendous significants of oil and gas as our basic energy supply and anything that cuts across that dramatically increases our vulnerability is adverse to the long term best interest to this country and we need to be concerned about it and I will try to raise those points effectively in the higher counsels.

Thank you very much --

CHAIRMAN MOSBACHER: Secretary Hodel, we

thank you, sir, for being here with us and hearing the views of concerned energy industry.

Now to our study committee reports. As you know and as many of you have already reviewed the counsel has had under consideration a draft report of the study requested by the Secretary of Energy regarding strategic petroleum reserves. As it's been circulated to the membership and reviewed, at this time Bill -- chairman of the NPC committed and the SPR reserve was to deliver the report. He's unable to be here. In his absence, Gordon Goering who is chairman of the committee's coordinating subcommittee will deliver the report. Mr. Goering.

MR. GOERING: Thank you, Mr. Chairman. Ladies and gentlemen, I am pleased to present to you this morning the findings and recommendations of the NPC committee on the strategic petroleum reserves. As you know, in November of 1983, the counsel was requested by Secretary Hodel to conduct a study of various aspects of the strategic petroleum reserve.

At that time, the Secretary also asked the counsel to examine current and projected tanker trends with an emphasis on tanker movements of SPR oil. Because of the inter-relationships of the study topics, the counsel agreed to address both requests in one study effort. In order to conduct a study, a study organization consisting of the committee on the strategic petroleum reserve, a coordinating subcommittee and four task groups was established to assist in responding to the Secretary's request.

The task groups were aligned along four critical operational areas considered in the analysis. SPR facilities, the overland distribution system, the water born distribution system and the domestic refinery industry. Early on the committee agreed to study the distributional aspects of the SPR and address policy issues only as they directed to impact SPR distributions.

With this in mind, the committee identified its key objective to determine the capabilities of the SPR system and the private sector to draw down, distribute and refine SPR crude oil at the SPR maximum draw down rate of 4.5 million barrels a day under DOE's current sale procedures. The committee felt that by testing the system at its maximum design draw down rate, the concerns raised by the Secretary regarding draw down and distribution capabilities, the SPR crude oil quality and refining capabilities to be addressed in terms of maximizing the flexibility of the SPR system.

The committee strongly believes that the SPR distribution system must be designed with the greatest amount of flexible flexibility possible in order to respond to a variety of supply emergencies and to adopt to constantly changing supply demand patterns. In light of our objective, that is, testing the system at the maximum 4.5 million barrels a day of SPR draw down are distributions -- or rather disruptions scenario was developed that virtually eliminated all crude oil and product imports into the United States.

The disruption was postulated for the year 1990 when DOE projects that the SPR fill will be completed and the maximum design draw down rate will be achievable. Thus it was necessary for study purpose to define business as usual, 1990 crude and product supply demand balances, refinery inputs and outputs and crude and product transportation patterns before the effects of our disruption scenario could be determined and SPR requirements defined.

Some key assumption regarding this scenario should be noted. The virtually total cut-off of all crude and product import to the United States actually meant that no net crude or product movements were allowed. But some Canadian crude imports were continued for quality and logistical purposes on an exchange basis. Domestic demand was restrained to a level equal to 1990 domestic production plus the 4.5 million barrels a day, a maximum SPR draw down with the underlying assumption that crude and product price levels would adjust during the disruption, such as demand would equal available supply.

It was also assumed that in the disruption market -- that in this disruption, the market forces would redistribute crude oil from refining centers with ample domestic crude oil to refining centers in import dependent area. Further, reductions and individual product demands were distributed equally among the countries five petroleum administration for defense districts. Although the demand reductions for each product category were defined separately on the basis of individual product elasticity.

The refining capacity was assumed to remain more then adequate to meed 1990 product demand. And for study purposes we treated the U.S. Virgin Islands and Puerto Rico as a part of the U.S. supply demand system. At this point I should digress for a moment and note that the study is in no way intended to forecast the supply and demand, pipeline availability or the manner in which refinery or transportation markets would actually respond during an emergency.

The committee realizes that the destruction scenario developed for the study is extreme and because it is impossible to predict how markets and consumers will respond to a given disruption scenario very ability from the responses put forth in this study must be expected.

It is for this reason, however, that the study analyzes the SPR system at its maximum design draw down rate. Because there would be little or no advance knowledge of the extent of the supply disruption, it's duration or regional impacts on consumers and markets, the SPR system must be designed with the greatest amount built-in flexibility in terms of meeting potential distribution and refinery requirements.

Only in this way will the system be able to midigate the effects of a wide range of possible supply shortfalls. I'm pleased to report that our committee believes that the strategic petroleum reserve is a valuable natural asset that is capable of being drawn down and distributed in the event of a national emergency. In general, we found the system to have been properly planned and operated. However, due to changes in the domestic energy picture, the committee recommends certain changes to insure the timely and efficient draw down, distribution and refining of SPR inventories.

Our recommendations are aimed at providing sufficient flexibility within the system to cover a reasonable range of potential SPR distribution and refining requirements and enhancing the system's abilities to minimize the effects of future supply disruption. I would like to present the studies specific findings and their associated recommendations.

Barring a sizable loss in refining capacity by further shut down, it appears there will be sufficient capacity in 1990 to process SPR oil in the available domestic crude oil production. However, the currently planned 1990 SPR crude oil quality mix does not provide adequate flexibility to meet potential refining system needs. Therefore, we recommend SPR purchases should be reoriented to insure that at least 43 percent of the planned 750 million barrel reserve is low sulfur crude oil.

The currently planned ratio of 35 percent low sulfur, 65 percent high sulfur crude oil could result in regional distribution inequities and/or compound refining difficulties in meeting product sulfur specifications. In order to achieve this recommended mix, DOE should act immediately to increase low sulfur crude oil purchases to at least 50 percent of the remaining sale and to designate segregated storage for this oil

Our second finding is since two major pipeline systems -- Seaway are no longer available to the SPR, current plans for location of future SPR fill would require additional Marine movements to supply Mid-western, lower Mississippi River refining centers thereby adding to Marine congestion in path three especially barge congestion. As a demonstration of the potential imbalance caused by the SPR location, the projected ratios of stored crude oil for local or pipeline connected refining capacity are 88 days at the Seaway complex, 193 days at Texoma complex and 28 days at the Capline complex.

Our associated recommendation is a ship of at least 100 million barrels of remaining SPR fill from the Texoma complex to the Capline complex should be considered. Since the Texoma and Sealine pipelines are no longer available to the SPR, part of the needs of path two that were to be served by these pipelines can be served via Capline. Congestion of water movements from he Texoma complex to refineries served along the Mississippi River maybe reduced by connecting one or more SPR sites to Louisianna offshore oil port facilities.

Most, if not all, of the refineries to be served by movements on the Mississippi River can be served by one of several pipelines connected to the LOOP storage facilities. For these reasons the allocation of SPR storage should be shifted in some fashion to the Capline complex. Further, such a ship would increase flexibility to met refiners crude oil quality needs and would ratify the inbalance in the days of crude oil supply stored at each of the three SPR complexes.

Whether to change the physical location of the storage or to connect existing sites by pipeline to the Capline area would have to be determined after the economics have been studied. Our next finding is upon completion of the SPR fill, the capacity to withdraw crude oil from the storage caverns will match the same design draw down capability of 4.5 million barrels a day. However, without capacity enhancements, none of the three SPR complexes will be able to deliver crude vessels, especially barges, and/or pipeline at the maximum prejected 1990 draw down rate, nor will there be sufficient flexibility to cover a reasonable range of possible ships in future distribution capacity or requirements.

We therefore believe that enhancements are necessary at all the SPR sites to increase distribution capacity and match draw down capability and to provide additional flexibility in the system. Specifically at the Seaway complex a one million barrel per day pipeline from Bryan Mound to the Texas City/Houston area should be constructed. Also the Phillips Dock should be considered for use in a draw down to supplement the Seaway dock.

With these enhancements, Bryan Mound draw down capability would be fully utilized. I should note that this recommendation is consistent with the current DOE enhancement proposal. At the Capline complex, St. James Terminal capacity should be increased from 880,000 barrels a day to 1.07 million barrels a day consistent with Wheats Island and -- draw down capability. This enhancement is required even if future SPR fill is not relocated to the Capline area and is consistent with the current DOE enhancement proposal.

At the Texoma complex, should economics dictate that future SPR fill be shifted to the Capline area and 860,000 barrel a day capacity enhancement is still required at this complex to make maximum use of draw down capability. Specifically 580,000 barrels per day of this through put enhancement should come from a nine mile, 26 inch pipeline from West Hackberry to Lake Charles and 280,000 barrels per day should come from increase terminal through put capacity available to DOE at Nederland.

These enhancements are also consistent with the concurrent DOE enhancement proposals. If a ship that the remaining SPR fill is not made to the Capline area, these Texoma complex enhancements should be supplemented by an additional 730,000 barrels per day in terminal through put and Marine loading capacity available to DOE at Nederland to meet the 1990 destructive dates as well as to provide flexibility for future demand ships.

Our third finding is that the lack of Ballast treatment facilities at SPR terminals which could constrain sustained loading rates by as much as 30 percent restriction distributed accordingly. We recommend therefore that Ballast water treatment facilities are alternate means of disposal should be provided at all SPR Marine facilities. As loading up crude oil requires some method to handle Ballast, a cost benefit study should be conducted to divine the most effective means of dealing with this problem.

Specifically the study should examine the possibility of constructing Ballast water treatment facilities at SPR Marine terminals, tying to nearby Marine terminals to increase doculation or injecting the Ballast water discharge from he vessels to the SPR caverns or exempting vessels loadings at the SPR terminals from the act to prevent pollution from ships 1980 during an emergency.

We found that the supply of U.S. flag tankers and barges in 1990 appears to be sufficient to meet the water born crude oil transportation requirements of an emergency draw down of the SPR. On the other hand, however, we found that projected defines in U.S. flag product tankers could result in a substantial shortage of U.S. flag tonage for the distribution of residual fuel oil during a supply disruption. Although an ample supply of U.S. control foreign flag tonage is readily available for participation if required.

Therefore, we recommend that Jones Act waivers if necessary should be expeditiously handled on a case by case bases. It appears that the level of demand of foreign flag tonage could be handled by existing labor procedures. However, a contingency plan should be developed by Mirad (phonetic) in advance of an emergency for expediting waivers of the Jones Act. Additional Mirad personnel should be allocated to foreign flag waiver evaluation if it appears that case by case request for waivers are not being expeditiously processed.

If the draw down rate is such that case by case waivers cannot be administratively handled, a blanket waiver would be granted to construction differential subsidy vessels enabling Mirad contingency plan procedure to concentrate on case by case waivers for foreign flag tankers to participate in the SPR draw down. Mirad should develop and have available to it a standby blanket waiver procedure on foreign flag vessels or for use in the event that the case by case waiver process results in delays of SPR distribution inspite of having taken the above action to ratify the situation.

Mirad should also establish an on-going vessel operators and shipping committee that would periodically meet to evaluate and recommend inprovements in Mirad's draw down response plan and update the vessel supply demand ballot. The committee would also be available in the event of a draw down to assist Mirad in assessing vessel availability and requirements in order to assure adequate protection of national interest.

Mirad should closely coordinate SPR crude oil refining requirements to whatever tonage the Department of Defense might require. I might add that at this point the recommendation on handling the Jones Act waivers is subject to a minority report. This minority review was sent to you last week and a copy is in the handouts this morning. We propose inserting it in he Marine appendix and refer to it in the appropriate places in the body of the report.

My next recommendation is that efficient use of tankers and barges should be promoted adopting minimum lot sizes such as 200,000 barrels per tankers and 40,000 to 60,000 barrels for barges which would help assure full utilization of vessel capacity. Proceeding with the proposal to relax the length restriction at the DOE terminal in St. James will open up the terminal for larger vessels. Also berthing facilities for barges should be substantially increased to handle path three distribution requirements.

Our next finding is that current SPR sales policies had environmental restrictions would limit the timely distribution and use of SPR oil in an emergency. Accordingly it is recommended that a --

should be put in place that would facilitate and expedite the distribution of SPR crude oil during an emergency. To promote the efficient draw down of the SPR and the timely distribution of petroleum products to consumers, it is recommended that SPR draw down amendment number four be modified from the present position of being open to all interested buyers to a more restricted list of purchases such as U.S. refiners, the purchasing agents and/or traditional suppliers.

Procedures should be established for precertification of qualified bidders. Also the damaged provision of the current standard sales provisions should be revised to ordinarily balance the responsibilities and liabilities of the purchaser and the DOE. As currently drawn, these provisions are accessively severe and place the entire burden to preform on the purchaser. Procedures to expeditiously process necessary environmental waivers should be established at the appropriate state, local and federal levels.

In the event of a disruption, variances maybe needed for products over specifications and/or facility admissions. Our final finding is that as with any system not operated on a daily bases, special attention should be given to conducting periodic training exercises for the entire SPR system and to improvements in equipment and procedure at the individual size. We therefore recommend that periodic draw down exercises should be conducted by the entire SPR organization to achieve and maintain administrative and operational readiness.

MR. GOERING: No physical sale of crude oil need be made to have an effective test exercise. Additionally, we recommend that equipment and procedures of SPR science should be improved. To increase the flexibility of the system, maximum use should be made of existing meters instead of tank gauges for custody transfer of SPR crude oil.

Corrosion protection for water and brine system should be improved. And a complete review of all bare pipe requirements should be made with a view of reducing inventories and coating the remaining pipe with a preservative.

Security of water intake structures, which are critical to drawdown, should be insured. These are the major findings and conclusions of the committee on this strategic petroleum reserve. Through this analysis, we have thoroughly examined the SPR system, and its ability to mitigate the impacts of future supply disruptions. We believe the resulting recommendations will provide additional needed flexibility, and strengthen this program that is so vital to our national security.

In conclusion, I want to recognize the dedicated effort of this coordinating subcommittee, the task groups, who contributed so much to the analyses and discussions contained in the draft before you today. The support given to the study by your company, has been truly outstanding. Equally invaluable was the cooperation and support given by Government, particularly the DOE strategic petroleum reserve, and energy emergency offices and the Energy Information Administration.

Mr. Chairman, this concludes my presentation on behalf of Bill Downs. I'd like to move the adoption of this report by the National Petroleum Council on the subject to final edited and the inclusion of the minority view. Thank you very much.

CHAIRMAN MOSBACHER: Thank you, Gordon.

We have a motion to adopt this report. Do we have a second?

AUDIENCE: Second.

CHAIRMAN MOSBACHER: We also have time for a discussion of this. And before we begin this discussion by the membership, we're planning to have a statement from a non-member, Mr. James Bordon, who would like to make a statement representing and on behalf of the Chemical Manufacturers Association. Mr. Bordon, if you would come down, please, sir. Speak at this microphone right there.

MR. BORDON: Thank you, Mr. Chairman, and good morning.

I'm manager of Economics and Policy Materials Logistics Department of the DuPont Company. I'll first mention I'm here today as chairman of the Chemical Manufacturers Association, Energy Committee. The Chemical Manufacturers Association is a nonprofit trade association whose members represent more than 90 percent of the production capacity for basic industrial chemicals in this country. The industry energy intensive one, as energy is used both for fuel and as feed stock. 1983, industry used approximately 6.4 percent of the nation's liquid petroleum as feed stock and another half percent as fuel. CMA numbers have a vital interest in issues effecting petroleum supply, and this is why I'm here today.

I appreciate the opportunity to speak at this meeting, relevant to your draft report on the SPR. The report certainly could be an aid to the

Government's effort to make the SPR an effective tool to reduce the impact of the petroleum shortfall, if you're on a curve. However, we do have a problem with one of the recommendations. CMA is very concerned with the possibility of NPC adopting a position which calls for restricted access to SPR oil at times of emergency.

This concern has its background in CMA's positions on emergent preparedness issues. CMA has consistently supported the position that market forces should be the primary means of resolving a petroleum shortfall, and opposes any form of Government price and allocation controls even on a standby basis. We first expressed this to this group as part of your emergent preparedness study about four years ago.

We have endorsed the building in SPR, its prompt utilization in time of need. CMA supports the concept of the sales of SPR oil for domestic use to the highest bidder, and an auction open to all with no purchaser priorities. Such a system for SPR distribution would, in CMA's view, provide maximum competition, the most efficient expression of the marketplace. We believe that would also be the fairest and most equitable system to all segments of the economy.

We thus support the present administration's policy that distribution of the SPR's described in the SPR Drawdown Plan Amendment No. 4, the sale to all interested buyers. We object to the recommendation being considered by NPC which calls for a more restricted list of purchasers such as U.S. refiners, the purchasing agents, and/or traditional suppliers. The limitation of potential bidders being considered for constituted purchase priorities, would be, in effect, an allocation of SPR oil to a single client's that the customer or consumer to the refiner.

This has several negatives in our view. First, the approach is inconsistent with the concept of relying on market forces as a primary mechanism for allocation of oil in emergencies. It would lead to less competition and more, you know, less responsive market as the number and types of bidders would be reduced.

Second, the system could be perceived as inequitable, as it would exclude major energy consumers,some of whom may compete directly with refiners and downstream petrochemical markets. A competitor for feed stocks might well feel himself disadvantage if he could not, at his option, bid for available petroleum supplies as can his refiner competitors. A consumer excluded from the right to bid for crude oil might believe that the Government allocation is required to insure an equitable supply of refined products is available for feed stocks.

A restriction on who can bid for SPR oil, could result in calls for downstream allocation. And this certainly would lead to a loss of our fundamental principal, maximum reliance in the free market for distribution of oil in a shortage. And as a result, instead in a morass of price and allocation controls and the inefficiences that stem from the control of the market.

Chapter five of the draft report stated that unlimited bidding may encourage purchasers to enter the system who lack expertise in petroleum refining distribution, marketing, and making the system less efficient. It should be noted that any company entering the bidding process incurs significant risk that fails performs prescribed in the sales agreement. I think you're all familiar with the financial and performance requirements of the sales agreement.

This in itself should limit the number of bidders. Many will deem it prudent. If they do, I'd like to have their interest represented by agents who have sufficient expertise in petroleum trading to minimize the risk. However, even if someone does enter the problem into the bidding and has performance problems, this risk to efficiency does not seem to outweigh the disadvantages of a system which restricts the number and type of bidders. It is our opinion that an open market directed distribution of the SPR oil is preferred to risking a distribution system encumbered by government allocation created through a response to perceive inequity.

To be effective, SPR oil should be released for sale by the government -- to be effective, SPR oil released for sale by the government should be dispersed and used in a timely fashion and not held for speculation. We therefore endorse steps to reduce speculation by potential buyers; restricting who can buy the oil does not address this problem, but rather it should be addressed in terms of sale and I think, in effect, DOE has done that.

Restricting who can purchase the oil, deviates from the market oriented concept of handling an emergency and leads to preserve -- perceived inequity. We urge you, therefore, to delete this recommendation from your report before reporting into the Secretary of Energy. I thank you for the opportunity to present our views to this group. If you'd like to elaborate on any point, I'll be glad to do so.

CHAIRMAN MOSBACHER: Thank you. Thank you, Mr. Bordon. Are there any comments from members of the Council, thoughts or questions? Yes, sir?

MR. GARY: I'm Jim Gary, Mr. Chairman, chairman of Pacific Resources, Honolulu. I represent an independent refinery. I filed a minority report involving the Jones Act. My company is primarily an independent refiner. We operate around the Pacific Basin. We move about 200,000 barrels a day thru our system. We bring 70,000 barrels a day into Hawaii for refining, and that's who our refiner is there, a subsidiary company, a joint venture company to which we own most of is a ship broker company that charters in, charters out, charters our ships as well as third parties around the Pacific Basin.

We've had a great deal of experience working with the Jones Act. I think we know it inside out as I'm sure some of the rest of you do.

We think that it is naive to believe that this system will work in an emergency without having some kind of a blanket waiver procedure already available ahead of time.

I realize that if you go up against maritime unions on a thing like this, I realize what all the difficulties are, as I said we have -- we've been through the process a thousand times.

The report assumes a worst case scenario, a true emergency in which all imports are not -- and if such procedure is not available, there isn't any doubt in our minds that this system is not going to work for all of us, therefore we have filed a minority report and we appreciate the fact that it will be included as such and properly referenced in the report.

CHAIRMAN MOSBACHER: Thank you, Mr. Gary.

Any other comments?

MR. GLANVILLE: It seems to me, that the -- of the Chemical Manufacturing Association if it's safe to say that the intricate buyers haven't seen those who would use the oil and who will not be allowed to resell this.

CHAIRMAN MOSBACHER: Is that in the form of a motion?

MR. GLANVILLE: I wonder whether that would meet the objection that the -- the position of the Chemical Manufactures Association will take.

CHAIRMAN MOSBACHER: So, perhaps, it is not in the form of a motion it is something that after the meeting could be addressed and discussed with the committee if there's some amendment they wish to make at a later time, is that -- since it's not, right now the report, unless it's motioned and seconded, it will read as is. Mr. Gary.

MR. GARY: If they know --

MR. HARTLEY: Just one -- you might understand that this report concludes that at the time of dislocation that all tanker flows in the West Coast and between the West Coast and the East Coast will continue without intervention -- foreign submarines, et cetera, et cetera.

We've have nothing to worry about out west.

CHAIRMAN MOSBACHER: I can't answer that one, or attempt to.

MR. GARY: The report assumes that, it assumes that without -- own attack tankers available, it doesn't get into whether they can keep operating or not, whether foreign submarines can sink them as fast as they move through the canal.

MR. HARTLEY: -- on land.

MR. GARY: Exactly, this is --

MR. HARTLEY: In the lower 48 states.

MR. GARY: This report does not get into other locations for a strategic reserve other than on the Gulf Coast, it's wrong in that extent, that was the length that we put it on developing the report in the first place.

CHAIRMAN MOSBACHER: This is included in the minority report, included in your report for the benefit of the Secretary.

MR. GARY: As Bill Long knows, we been -- there has been a strong motion underway instigated by us in Hawaii to have a portion of the strategic petroleum reserve ultimately established in Hawaii, based on military needs that kind of thing.

We're major to suppliers to the military installations around the Pearl Harbor complex. Having -- as far as Hawaii is concerned, having a strategic petroleum reserve on the Gulf Coast is like have a strategic petroleum reserve for New York City in Istambul.

CHAIRMAN MOSBACHER: Any of other --

MR. HARTLEY: I understand that the Secretary's question to the MPC committee, we are instructed to forget about the West Coast. That's not a problem because there's plenty of supply out there and the supply lines will be kept open.

CHAIRMAN MOSBACHER: I believe, and I'm sure you came here a representative of the committee, but the West Coast companies our represented and this is a consensus report, is that right Mr. Gary?

MR. GARY: Yes, Mr. Chairman, we interpreted the Secretary's letter for us to study the ability of the DOE, the draw down, the SPR storage of $4.5 million barrels, investigate whether we have tankers available to contribute, tankers and barges available contribute the oil and also, do we have a refining capacity compatible to process the SPR oil, plus a domestic production.

We did not address regional storage requirements, we were not asked --

CHIARMAN MOSBACHER: Any other comments. Yes.

MR. BADEN: I'm John Baden, from -- an I do not idly stand by and go and challenge the presumption that speculation is bad and speculators are evil people. Which was the implication of the last speaker, from the chemical industry.

It is precisely the role speculators to hold resources out of consumption until time when they're most, more valuable. When they are needed more.

It's a very legitimate function of the market. Prices represent -- and information. Speculators act precisely upon that, and it seems to me that we should recognize the speculation is a legitimate and extraordinary valuable function in any society to derive the book prices and the market process would coordinate the sources.

So I would take very strong exception on the anti-speculators statement made by the guest speaker.

CHAIRMAN MOSBACHER: Thank you, Mr. Baden.

Anything else?

MR. VAUGHAN: Mr. Chairman, Mr. Chairman?

CHAIRMAN MOSBACHER: Yes. Secretary Vaughan.

MR. VAUGHAN: I believe it's important to note from the Government's point of view and I did this at the committee meeting, that it is well established that this administration has a policy and it is in place and in affect, and is the law at the moment that any citizen or group of citizens that help pay the taxes to fund this reserve shall have access to it if they so position themselves, and make the bids in the appropriate format and so on.

And I think, quite candidly, we are somewhat disappointed at the recommendation without very much data to back it up, I might add in the report itself, more philosophical than data oriented that there would restrictions on the buyer universe.

And I think I would point out that this is now my count, 3 groups that -- actually, 4 groups that have raised this point rather rigorously. The Chemical Manufacturers Association, Petrochemical Energy Group which came before the main committee at its last meeting.

At an earlier meeting the Petroleum Industry Research Group, and now this gentleman and I've certainly have raised some remarks from the Government's point of view about this subject of reducing the buyer universe.

And certainly included in the Government's concern with that is the inference that there are any elements of the market society; speculators, traders, producers, refiners and final product manufacturers, that Government could go along with declaring necessarily bad, or right or preferred. And we certainly, in that sense, are disappointed with that portion of the report.

Interestingly too, I feel constraint to point our in endorsing the part which Cary has said about the limited approach to the Jones Act waiver. I am confused at the inconsistency that the study committee seems to engage in, as illustrated by these two items of concern, and in this I mean that the justification as I understand it for restricting the buyer universe is to -- that we need to get this oil out and refined and so on. And yet, the same committee went along with trying to deal with a similar type shortage on a case-by-case Jones Act basis rather than a general policy of Jones Act waivers.

It seems to me that it is a glaring inconsistency and one that which is not reconciled in any way that I can see by the data.

CHAIRMAN MOSBACHER: Thank you, Secretary Vaughan, as you well know this study was undertaken at the request of the Secretary. It is for his advice to use as he sees fit. It is obviously not mandatory.

I think it's very healthy that there's some disagreement both in the Council and between the Council in the report and portions of the Department of Energy and I think that's in the best tradition of democracy --

MR. VAUGHAN: I agree.

CHAIRMAN MOSBACHER: -- thank you, and now --

AUDIENCE: I feel, compelled to respond to this since the Secretary commented, I'm Joe Massy, I was the chairman in the marine task group and I think there's been fairness to the member of the committee, it should be aired here that the reason for the difference in opinion that the Assistant Secretary has pointed out, I think that the data contained within the report clearly highlights that based upon the requirements for distribution by marine methods developed by the study, there were sufficient tankers with a minimum shortfall in the production area.

We're talking probably in the area of 10 to 12 waivers that would be required to be handled by the Maritime Administration Law. I think the reason that the difference, and I participated in the subcommittee discussions of the universe of buyers discussions, that we are not talking about handling by a Government agency 10 or 12 waivers that would probably be processed two or three a week, but rather a multitude of people responding to bids for various cargo -- on a repetitive basis, there's a significant difference, and to class the two together as a dichotomy of opinion on the part of the subcommittee is inherently to overlook the data that is contained within the report.

Thank you.

CHAIRMAN MOSBACHER: Thank you. All right, it's been moved and seconded to receive the report as written on the strategic petroleum reserve. All in favor please say aye.

AUDIENCE: Aye.

CHAIRMAN MOSBACHER: Opposed by nay, thank you. Now, we move on that before I finish I would like to say two things.

One, we thank you, Mr. Gary, and all those who worked so diligently to make this report the comprehensive and effective report it is and secondly, I would like to add that since we have heard from the Secretary this morning regarding the SPR perhaps being suspended at 500 million barrels, that I would like to add a letter in transmittal when we send this report to the Secretary regarding the validity of the report under those circumstances.

If the SPR is temporarily suspended and then ultimately assumes our recommendations are, of course, valid. On the other hand if the SPR -- permanently captured 500 million barrels and the associated maximum drawdown is lower, the vast majority of our recommendations would still be totally applicable.

Obviously, the recommendations on the -- location of remaining fill would become somewhat moot but the rest would most likely remained basically unchanged. The report contains the data and analysis to judge what enhancements may be needed with various maximum drawdown rates.

There's no objection from the NPC membership -- I had planned to incorporated these comments in an overview of the Secretary Hodel has a letter covering the report. I believe this would allow the reader to properly interpret our report if changes are made in the -- level of the SPR fill.

Are there any objections?

Then I'll will do that. We will move now to the progress report of the committee for U.S. petroleum refinery has been under this report has been underway and has been requested also by Secretary Hodel at our last meeting.

It's a most important effort and John Mckinley has stayed through the whole procedure, I'm glad to see you have some company. You are the next speaker, and would you give your report please, John?

MR. MC KINLEY: We still have more than the one that Secretary Hodel's story told about. I will be brief.

At the last meeting Secretary Hodel requested the National Petroleum Council to undertake a new study of the factors affecting the domestic refining industry in the period 1985 to 1990.

The purpose of this study is to update previous NPC studies and evaluation of the future refinery operations and the industry's ability to meet the demands for petroleum products.

The Secretary specified that the study should examine capacity changes including announced refinery closings which as you know in the last couple of years have been rather, quite numerous.

The bottleneckings, the additions to refineries, equipment types and projected role of the small regional refiner in this future period. Also, related environmental and regulatory issues are to be addressed as appropriate.

The last NPC refining study was completed in 1980. It looked at analysis of aggregated world and U.S. energy supply and demand projections, looked at U.S. domestic refining industry capacity and capability to process available crude oil to meet the future product demands.

It looked at competitive position of various segments of the U.S. refining industry and the competitive economics of supplying incremental U.S. East Coast product demands by refiners inside the United States or by imports into the United States.

These analyses were based largely on data collected in 1978 and the projections also made at that time in '78 with regard to 1980 and 1990 timeframes.

Now, it's clear to all of us that quite significant changes have taken place both in domestic and foreign refining industry since the time of that last study; perceptions of the world as to growth and needs and production volumes are greatly different, thus justifying the secretary's call for this relook at this situation. Now, in other to assist the council in responding to the secretary's request, our Chairman, Bob Mosbacher, on October 16th of '84 appointed the committee on U.S. petroleum refining.

The committee held it's organizational meeting on November 12th and approved the scope on an organizational structure and a timetable for this study.

A copy of this study plan is in your handouts and I will very briefly summarize the contents of it.

In defining the scope of the study the committee determined that they should use an approach that combines those used in the last two NPC studies of this subject. Those were done in 1980 and in 1973.

The 1980 study was primarily a presentation of data and analysis on current and projected refiner capabilities that were developed based on industry surveys, questionaires sent to members of the industry.

The NPC's 1973 study, however, included discussions and recommendations on a range of Government policy issues and placed less emphasis on the collection and presentation of data.

The new study or in this new study the capability of the U.S. domestic refining industry to produce the required products will be analyzed under a variety of scenarios of crude oil availability and product demand.

Data from the surveys on current and projected crude oil supply and demand and refinery operations and facilities will be used to determine the facility requirements; what is needed in equipment, the installation costs related for the 1985 - '90 period. In addition, the effects of certain federal regulatory actions and market forces will be studied and the topics included in this may be a very important part of this study and they'll include the following, and others as may be suggested: Current and future impacts of product imports; competitive economics of our domestic refining segments; gasoline lead restrictions; other environmental restrictions, including more gasoline vapor pressure limitations; limitations on motor gasoline octane enhancers, such as lead substitutes; kimitations on hydrocarbon blending components, such as benzene and others that may be claimed to have health problems; sulfur content limitations in diesel fuel, number two fuel and jet fuel or turbine fuels; SOX admissions; taxation and Superfund requirements as they impact on the domestic refining industry; the regulation of high sulfur coke as our refining industry has done more to the production of light products and coking has increased in importance; and of course, product availability.

The NPC 1980 study required a large survey and computer effort. Now, the individual companies were surveyed for their forecast of future oil supply and demand and for detailed refinery capability data, including crude and product slates and operational costs.

Responses were collected by a public accounting firm, which also performed a significant amount of computer aggregation of the data, so that no one was seeing or looking at an individual company's data or and individuals company's projections of what would happen.

The new study will involve a similarity, with separate surveys being made -- questionaires and surveys being made on the domestic refinery operations, and separately on oil supply and demand question.

These new surveys will be sent out to industry very shortly, hopefully right after the first of the year and many of you here will be receiving those questionaires and I think it's rather obvious that the responses and the quality of the data received back by the study group is the foundation of the value of anything that we may be able to report to the Council.

So we ask everyone's cooperation in coming forward with the best of there data basis. Now, again, we will use and independent public accounting firm to receive this information and only the aggregated results will be provided to the Council and to the study groups that are working for the Council.

To assist the committee in carrieing out the study, an organizational structure consisting of a coordinating subcommittee and four task groups have been established.

The coordinating subcommittee will address the broader issues and coordinate the work of the task groups. The specific task groups are as follows: Number one, the oil supply and demand. That will be chairmaned by Roger Hemmingshouse of Diamond-Shamrock; the refinery survey, that will be by Lloyd Bush of Ashland; refinery capability, Herbert Hand of Floor Corporation, and worldwide refining trends by John McDonald of Sohio. Jim Seamans of Texaco is acting as chairman of the coordinating subcommittee and I'm please to note the outstanding cooperation that we've been receiving because I think the industry has a high level of concern about the future of the refining industry in the U.S.

What's by all these groups is now, pretty much underway and seems to be going well. We've selected a fairly ambitious schedule that provides for the completion of this study by the end of 1985.

And it calls for various meetings and work sessions for the subcommittee and for the task groups. The committee will meet as necessary throughout the year and we will meet in November to consider a final report for submission to the Council, Mr. Chairman.

That concludes my report, the chairman of the coordinating subcommittee is here, if there are questions or suggestions, we would be glad to receive them.

CHAIRMAN MOSBACHER: That you, John. I appreciate the efforts that you're off to such a good start. Are there any questions or comments?

Now, we appreciate that there is no motion that need to be made, now action by the Council at this time, this is a progress report. Before we go to the administrative matters, Secretary Vaughan, I would like you to say a few words if you wish.

MR. VAUGHAN: Mr. Chairman, I think it's appropriate, even though the hour is late, with respect to the report that we are receiving on the strategic petroleum reserve to thank the Council on behalf of the Department and the Secretary, Administration, not only for a report of that required a awful lot of work but a report that we asked for on an expedited basis and it is being delivered on an expedited basis timely.

We very much appreciate that, and we very much appreciate the tremendous amount of effort that went into the preparation of that report and while there may be some specific disagreements, I think it would be inappropriate not to point out the Department very much appreciated the responsiveness of the Council members in turning out this report and it is particularly important that it validates the majority of the current enhancment work that is going on at the SPR and allows us to proceed with a high degree of confidence to what we planned out the correct thing to do, and gives us some challenges in yet some other areas that we had not thought about.

Thank you very much.

CHAIRMAN MOSBACHER: Thank you, Secretary Vaughan. Now, we will proceed with administrative matters and first and foremost, we'd like the finance committee report by its chairman, John Phillips.

MR. PHILLIPS: Mr. Chairman, I am the last speaker.

The finance committee met yesterday to reviews the financial status of the Council. We review expenditures and receipts for the first 11 months of 1984 and looked at projections for the remainder of the year.

I'm pleased to report to you that the financial position of the council remains strong. We also discussed a budget for calendar year 1985 and are recommending it be set at $1,948,000, approximately the same as 1984.

This budget includes funds to conduct the U.S. petroleum refining study that John McKinley has just reported on and provides additional funds to respond to the request that the Secretary may make in the upcoming months.

The committee also discussed recommended contributions for fiscal year 1985 - '86. As you may recall, we are on a calendar year for our expenditures but our contributions are on a fiscal year of July 1 - June 30th.

Even though the final decision on member contributions will be made at the spring meeting, it appears that the consolidation of our industry and perhaps proposed tax policy administration, that plus the scheduled studies for 1985, it will probably be necessary to modestly increase the member contributions for '85, '86.

MR. PHILLIPS: Mr. Chairman, I make a motion to submit this to the council.

CHAIRMAN MOSBACHER: The motion has been made and seconded and all in favor say aye.

AUDIENCE: Aye.

CHAIRMAN MOSBACHER: Opposed, nay.

I thank all of you for continuing support of the council. And I think, John, we thank you particularly. John Phillips has been Chairman of this committee. He's done yeoman service, has done a great service to the council, industry and I think to the nation for over four years. So long neither of us can remember how long it has been and he's been a great leader for our finance committee.

Thank you, John.

CHAIRMAN MOSBACHER: Now winding up, we have as a tentative date for our next meeting, May 22nd, May 22, 1985. And we'll get out official notices of that effect.

Is there any other matter to be brought before the council, any new business, old business? Any non-council members want to make a statement? If not, we stand adjourned.

Thank you.

(Whereupon, at 12:23 p.m. the conference was concluded.)

C E R T I F I C A T E

This is to certify that the attached proceedings

before the Department of Energy
(Name of Agency)

in the matter of: National Petroleum Council

Docket Number:

Place: Washington, D.C.

Date: December 12, 1984

were held as herein appears, and this is the original transcript thereof for the file of the Department or Commission.

Andrew B. Hait
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Official Reporter