Large Public Power Council
Critical Issues Brief
March, 2001

LPPC

- The Large Public Power Council comprises 20 of the nation’s largest community-owned and operated electric systems from across the country. Our members own and operate over 44,000 megawatts of generation. In addition, we own and operate in excess of 24,000 circuit miles of transmission lines, and serve major urban centers as well as outlying suburbs and rural communities.

ENERGY POLICY

- Across the country, LPPC members are seeking to meet their customers’ needs by ensuring adequate generation, ensuring that the transmission system is used efficiently and ensuring that new generation and transmission can be constructed.

- We strongly support fuel diversity. Our membership comes from areas of the country with access to coal, hydropower, natural gas, renewable and nuclear energy. LPPC supports enhanced, environmentally responsible development of all of these resources. Environmental policy should flow from this “fuel diversity” strategy.

- Within the energy policy debate, we will look to these measures to ensure fuel diversity:
  - Clean Coal technology funding
  - Reform of the hydro relicensing process combined with appropriate classification of hydro as a renewable
  - Incentives for the electric power industry to develop additional renewable and alternative fuels and ensure parity for public power

- Enhanced transmission must go hand-in-hand with enhanced generation.
  - New, improved transmission planning and streamlined siting mechanisms are needed to assure adequate transmission.
  - Provisions to remove federal tax constraints (contained in Secs. 957 – 959 of Senator Murkowski’s energy bill), including private use, are necessary to ensure that all utilities use new and existing power lines as efficiently as possible, and to ensure that new transmission can be built. Power must be delivered where it is needed without being hindered by an outdated tax code.
LPPC members also encourage measures that will help us and our customers achieve greater energy efficiency and conservation.

LPPC members in the West, from Sacramento to Washington State, are facing serious effects from the failed California restructuring initiatives, combined with generation and transmission shortages. In the near term, we support efforts by our Western members to find regional solutions that can counteract the irrational pricing that has been created by this environment.

The debate has temporarily shifted away from national wholesale market structure issues. It remains essential to build robust wholesale markets, with independent RTOs, a national reliability organization to enforce mandatory reliability standards, and appropriate authority for FERC to address market power and mergers.

To build a well-functioning wholesale market, Tennessee Valley Authority’s role in the Southeastern markets must be addressed by Congress. And, the cost-based rates offered by PMAs to their customers must be preserved to maintain stability in the marketplace.

ENVIRONMENTAL POLICY

Environmental policy should be based upon a national energy strategy that ensures a diversified fuel mix, which includes increasing use of coal, natural gas, nuclear, hydro, wind, biomass, landfill gas, solar and other renewable technologies.

LPPC supports a multi-part, flexible approach to reducing carbon concentrations in the atmosphere.

LPPC does not support regulation of carbon as a health-based (NAAQS) pollutant.

Continued research and sound science is fundamental to the development of a carbon strategy.

A carbon strategy must provide full flexibility to achieve goals or targets. Flexibility means that all activities and measures resulting in an ultimate reduction or stabilization of greenhouse gas emissions should be recognized. Such activities or measures may include, but are not limited to, increased renewable technologies, conservation and efficiency improvement initiatives, carbon sequestration projects and mitigation of other greenhouse gases.
April 13, 2001

The Honorable Spencer Abraham
Secretary of Energy
1000 Independence Avenue, S.W.
Washington, DC 20585

Dear Secretary Abraham:

Congratulations on your leadership at the Department of Energy in developing a National Energy Policy.

The business of chemistry is America’s leading exporting industry and one of the nation’s largest consumers of energy. We have been hit hard by recent price increases. We stand ready to assist you in your efforts to increase supply, expand existing infrastructure and improve efficiency toward the goal of lower costs and greater energy independence.

We are concerned about possible amendments to the Public Utility Regulatory Policies Act (PURPA). Existing PURPA provisions include mandatory connection to the grid, backup power at non-discriminatory prices and the sale of excess power. Without these protections, many of our industry’s cogeneration facilities and the manufacturing plants they serve will be at the mercy of electric utilities that view them as direct competitors.

The business of chemistry is heavily reliant upon cogeneration (the sequential generation of electricity and heat) for many of our production processes. The statutory provisions of PURPA have allowed our industry and others to utilize cogeneration within markets dominated by monopoly electric utilities. Any changes to the provisions impacting qualified facilities (QFs) will undermine your efforts to solve our nation’s electric generation shortage by jeopardizing existing power generation and limiting the potential for certain new generators.

The benefits of cogeneration were made evident by a report issued by the Congressional Research Service last year that included these findings:

• The energy savings from cogeneration in 1997 was equivalent to the electricity use of 11.2 million households, or 5 percent of U.S. oil imports.

• NOx emissions savings from cogeneration in 1997 were equivalent to eliminating the exhaust of more than 39 million vehicles.

FREDERICK L. WEBER
PRESIDENT AND CEO

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April 13, 2001
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- Without cogeneration made viable through PURPA, U.S. electric utility emissions of SO₂ would have been 18 percent higher in 1997, with NOₓ emissions 14 percent higher.

For these reasons, we would ask that the Administration oppose any attempts to modify existing PURPA language and thus jeopardize our industry's cogeneration contribution to the nation's electricity supply.

Sincerely,

[Signature]
Frederick L. Webber
President and CEO

cc:  Joe Kelliher
     Sr. Advisor to the Secretary
     Dept. of Energy

     Andrew Lundquist
     Executive Director of the
     National Energy Policy Development Group

     Karen Knutson
     Deputy Director of the
     National Energy Policy Development Group
STATEMENT OF CRAIG MOYER,  
MANATT, PHELPS & PHILLIPS  
SUBMITTED ON BEHALF OF  
THE WESTERN INDEPENDENT REFINERS ASSOCIATION  
BEFORE THE HOUSE SUBCOMMITTEE ON ENERGY AND AIR QUALITY  
MARCH 30, 2001

On behalf of the Western Independent Refiners Association (WIRA), in my capacity as counsel for WIRA, I am pleased to provide this statement for the record providing an overview of the current challenges facing small business refiners (refiners with fewer than 1500 employees and less than 155,000 barrels per day total capacity). WIRA is a trade association of small and independent refiners on the West Coast. At this time, ten small independent refineries continue to operate on the West Coast, nine in California and one in Tacoma, Washington. In California, these refineries are located in each of the three refining areas within California. One is located in the San Francisco Bay area. One is located in the Bakersfield area of the Southern San Joaquin Valley and the remaining facilities operate in the Los Angeles Basin. Small independent refineries employ thousands of people and each company pays millions of dollars in taxes, even after excluding income taxes. WIRA members produce a full slate of petroleum products including everything from gasoline, diesel fuel and jet fuel to asphalt, lube oil and specialty petroleum products. At this time, when it so clear that all domestic energy sources should remain viable and that no domestic source should be overlooked, I believe that it is important for this Subcommittee to understand the role of small refiners to the energy supply of our nation.

The Pro-competitive Role of the Small Refiners

Small and independent refiners have long been recognized as an important competitive force in the refining sector. Individually, each small refiner represents a relatively small share of the petroleum product marketplace. Cumulatively, however, their impact is substantial. Their pricing competition pressures the larger integrated companies to lower prices to the consuming public. Without that competition pressure, consumers will pay more. For example, in early 1991, Amoco shut down a 40,000 barrels per day refinery in Casper, Wyoming, and gasoline prices jumped almost 10 cents per gallon. In California, the Attorney General concluded that after five small refiners shut down because they could not manufacture California's cleaner burning gasoline, the loss of competition cost consumers hundreds of millions of dollars. Through experience, we know that when small refiners leave the marketplace, prices go up and consumers suffer.

Congress and many agencies, including the Environmental Protection Agency ("EPA") and the California Air Resources Board ("CARB"), have long recognized the importance of the independent refining sector to maintaining a competitive market for petroleum products. For example, after EPA promulgated rules limiting the sulfur content of diesel fuel to 500 parts per million effective October 1, 1993, Congress recognized the implications of this rule on small diesel refiners and authorized the issuance of acid rain credits to small diesel refiners pursuant to Section 410 (h) of the...
1990 Clear Air Act amendments. Because of the important pro-competitive impact of small refiners, CARB, an agency that has promulgated perhaps the most stringent fuels regulations in the country, has provided separate treatment for small refiners in virtually every fuels regulation it has passed since 1988. In its two most recent fuels rulemakings, EPA has authorized separate treatment for small business refiners, as well. Even the South Coast Air Quality Management District, an agency leading the nation and perhaps the world, in stringent air quality regulations, authorized separate treatment for small refiners in its recently promulgated Rule 431.1 regulating diesel fuel.

In addition to maintaining competition, small and independent refiners often supply other petroleum products not otherwise available in certain areas. For example, small refiners manufacture 100 percent of California's grade 80-aviation fuel, aliphatic solvents, and JP-4 jet fuel. Small refiners also manufacture 100 percent of the asphalt produced in southern California and much of the off-road diesel fuel. Half of the diesel fuel produced in the San Joaquin Valley, California's farm belt, is refined by small refiners.

Small business refiners also fill a critical national security function. For example, in 1998 and 1999, small business refiners provided almost 20 percent of the jet fuel used by U.S. military bases. This adds up to almost 500 million gallons of jet fuel supplied each year under defense contracts between the government and small business refiners.

Challenges Facing the Industry

Today, approximately 124 refineries are operating in this country. About 25 percent are small, independent refiners. Small business refiners are primarily owned by U.S. citizens including privately held businesses and one farmer cooperative.

As Secretary of Energy Spencer Abraham noted in recent comments to the United States Chamber of Commerce, the number of American refineries has been cut in half since 1980. Many of these were small business refiners unable to meet the challenges of poor refining margins and expensive regulations. Meanwhile, no new refinery has been built in the United States in over 25 years and regulatory requirements limit the ability of existing refineries to expand capacity. Government regulations require the production of more than 15 types of gasoline. Existing refineries are operating at capacity resulting in more frequent unplanned shutdowns. Every small refiner forced from the marketplace increases our vulnerability. Given the foregoing, one must agree with Secretary Abraham that we "have a refining industry strained to capacity, leaving us dangerously vulnerable to regional supply disruptions and price spikes."

Some of the major challenges facing small refiners in today's market include:

- Small refiners are large users of electricity and natural gas. The remarkably high prices of these inputs are affecting the small refiners.
- The phase out of MTBE as an oxygenate will lead to increased costs as reformulations are required.

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Obtained and made public by the Natural Resources Defense Council, March/April 2002
• Access to crude oil is an ongoing challenge, as large companies merge and the remaining mega-companies are not consistently willing to supply small refiners.
• Wastewater treatment controls and stationary source air quality controls have become increasingly stringent, thus raising costs for small refiners.

The challenges facing small refiners continue. Not only must they compete head to head with some of the largest companies on the planet, but also they must comply with increasingly stringent government regulations. Of most concern: on January 18, 2001, the EPA published new regulations, which create new standards for levels of sulfur in highway diesel fuel beginning in June, 2006. Under the new regulations, refiners must meet a stringent new standard of 15 parts per million sulfur limit for most on-road diesel volume (“Ultra Low Sulfur Diesel Fuel”). Small refiners produce about four percent of the Nation’s diesel fuel and in some regions produce over half of the diesel fuel. In the final rule, EPA stated regarding the diesel sulfur standards “that small business refiners would likely experience a significant and disproportionate financial hardship in reaching the objectives of our diesel fuel sulfur program.” In the final rule, EPA agreed with the final Small Business Administration report regarding the diesel sulfur standards “that small business refiners would likely experience a significant and disproportionate financial hardship in reaching the objectives of our diesel fuel sulfur program.” However, EPA has made no provision to assist small business refiners in financing the mandated capital expenditures.

The new regulations also will make it even less likely that new refineries will ever be built. With the exception of one small topping facility in Alaska, no new refinery has been built in the United States for almost 20 years. Existing facilities are operating at full sustainable capacity. Operational demands imposed by the new regulations will result in a reduction of on-road diesel production. At the same time, U.S. consumer demand for diesel fuel, as forecast by the Energy Information Administration, is expected to grow by 6.5 percent between now and 2007. If small business refiners are eliminated from diesel production, supply shortages will become even more likely. Therefore, it is important to seek methods to reimburse small business refiners for their costs in meeting these new government imposed mandates, which endanger their long-term economic viability.

EPA estimates that small business refiners will incur average capital costs of $14 million per facility to meet the new diesel regulations. For some facilities, the cost will be substantially more.

In addition, costs to produce low-sulfur gasoline and to comply with other regulations will add significantly to capital requirements in approximately the same time frame. Such capital investments are significantly beyond the financial capability of facilities operated by small business refiners, whose total investment is dwarfed by these requirements. On top of the initial required capital expenditures, the related increases in operating costs could equal or exceed the refineries’ historical annual profits, and thus, imperil the viability of these important US businesses.
While WIRA does not oppose the regulation, and is fully committed to compliance, we believe that national energy policy should take into account the importance of the small refiners and should include proposals for mitigating the impact of this regulation. Without such provisions, some small business refiners will shut down and all will struggle to meet the mandated expenditures. Such a policy ignores the important role of the small business refiner in the U.S. energy market. The result of such a policy will have serious consequences for our country.

Conclusion: U.S. Government Energy Policy Should Recognize the Role of the Small Refiner

The challenges to small business refiners, including the need for mitigation for the impact of otherwise appropriate environmental policies, should be recognized by the Congress and should be addressed in overall U.S. energy policy. If this does not occur, and small refiners go out of business, the competitive fabric of the U.S. oil and gas industry will be irreparably damaged.

Thank you for your consideration of these important comments.
Western Independent Refiners Association

Impacts of EPA Regulation

Small Refiners Are Key

- WIRA represents refiners with fewer than 1,500 employees and less than 155,000 barrels per day total capacity. WIRA members produce a full slate of petroleum products including everything from gasoline, diesel and jet fuels to asphalt, lube oil and specialty petroleum products.

- Today, approximately 124 refineries are operating in this country. About 25 percent are small, independent refiners. Small business refiners are primarily owned by U.S. citizens, including privately held businesses and one farmer cooperative.

- Small independent refineries employ thousands of people and each company pays millions of dollars in taxes, even after excluding income taxes.

- In addition to maintaining competition, small and independent refiners often supply other petroleum products not otherwise available in certain areas. For example, small refineries manufacture 100 percent of California’s grade 80-aviation fuel, aliphatic solvents, and JP-4 jet fuel. Small refineries also manufacture 100 percent of the asphalt produced in southern California and much of the off-road diesel fuel. Half of the diesel fuel produced in the San Joaquin Valley, California’s farm belt, is refined by small refineries.

Refining Capacity is at a Maximum

- As Secretary of Energy Spencer Abraham noted in recent comments to the United States Chamber of Commerce, the number of American refineries has been cut in half since 1980. Many of these were small business refiners unable to meet the challenges of poor refining margins and expensive regulations. Meanwhile, no new refinery has been built in the United States in over 25 years and regulatory requirements limit the ability of existing refineries to expand capacity.

- Government regulations require the production of more than 15 types of gasoline. Existing refineries are operating at capacity resulting in more frequent unplanned shutdowns. Every small refinery forced from the marketplace increases our vulnerability. Given the foregoing, one must agree with Secretary Abraham that we “have a refining industry strained to capacity, leaving us dangerously vulnerable to regional supply disruptions and price spikes.”

Federal Regulations Burden Small Refiners Disproportionately

- On January 18, 2001, the EPA published new regulations, which create new standards for levels of sulfur in highway diesel fuel beginning in June 2006. Under the new regulations, refiners must meet a stringent new standard of 15 parts per million sulfur limit for most on-road diesel volume (“Ultra Low Sulfur Diesel Fuel”).

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Mitigation Required

- Unmitigated, the new regulations will make it even less likely that new refineries will ever be built. Therefore, it is important to seek methods to reimburse small business refiners for their costs in meeting these new government imposed mandates, which endanger their long-term economic viability.

- EPA estimates that small business refiners will incur average capital costs of $14 million per facility to meet the new diesel regulations. For some facilities, the cost will be substantially more.

- Costs to produce low-sulfur gasoline and to comply with other regulations will add significantly to capital requirements. Such capital investments are significantly beyond the financial capability of facilities operated by small business refiners, whose total investment is dwarfed by these requirements. On top of the initial required capital expenditures, the related increases in operating costs could equal or exceed the refineries' historical annual profits, and thus, imperil the viability of these important US businesses.

- WIRA does not oppose the diesel fuel regulation. We are fully committed to compliance. We believe, however, that national energy policy should take into account the importance of the small refiners and should include proposals for mitigating the impact of this regulation. Without such provisions, some small business refiners will shut down and all will struggle to meet the mandated expenditures. Such a policy ignores the important role of the small business refiner in the U.S. energy market. The result of such a policy will have serious consequences for our country.
Dave Nevius, David Cook and I would appreciate the opportunity to visit with you sometime soon to talk about reliability legislation. As you may know, Senator Gordon Smith has introduced the Gorton bill of last year (S. 172). Mr. Wynn and others have introduced legislation similar to the Wynn Bill of last year, which includes RTO coordination amendments (H.R. 312). I understand that you are working with the Vice President's task force on a Comprehensive Energy Strategy. We would like to talk with you about making the NERC reliability legislation a part of that strategy, and address any questions you may have about our legislative effort.

Dave would also be prepared to talk about the status of NERC's summer assessment, and how things look to them.

I know you are swamped. Please just let me know when you could fit us in, and we will be there.

thanks and best regards,
Linda
As we discussed, please find attached a short paper on the U.S. oil and natural gas supply situation, together with a list of steps that the Administration could take at once to alleviate the situation. I will send you additional materials under separate cover.

Jim Ford
Federal Relations Director
American Petroleum Institute
682-9210
fordj@api.org
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Jim Ford
Federal Relations Director
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602-8210
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Overview: U.S. Oil and Natural Gas Supply Situation

Energy has not been an overriding government priority for some time. The energy problems of the past year have showcased the price we are having to pay for the failure to develop an effective national energy policy. Time is not on our side. U.S. energy concerns must have a place at the decision-making table and the energy impact of government decisions must be carefully weighed.

Crude Oil

The Department of Energy has forecast U.S. energy consumption between 1999 and 2020. While natural gas rises from 23 percent of consumption in 1999 to 28 percent in 2020, oil stays about the same (40 percent in 1999 and 39 percent in 2020). Seventy percent of petroleum consumed in the U.S. is for transportation. Most recent energy studies agree that this share is likely to continue well into this century — even with strong increases in energy efficiency and a rapid infusion of new technology.

However, under the best of circumstances, the U.S. will become more and more dependent on oil imports. This dependency now amounts to about 57 percent of U.S. oil demand. DOE projects that 64 percent of oil demand will be met by imports in 2020. In order to ensure reliable and secure sources of oil, we have no choice but to diversify the sources of our supplies, both domestic and foreign, and increase both. The U.S. oil and natural gas industry has the advanced technology needed to find and produce oil and gas in an environmentally safe manner.

However, domestically, access to federal government lands has become an acute problem. For example, from 1983 to 1997, access to federal lands in eight Western states declined by more than 60 percent — and that does not reflect major land withdrawals since 1997. At the same time, the U.S. oil and gas industry's ability to compete for opportunities abroad have been threatened by two U.S. policies: the alarming tendency to use unilateral economic sanctions against oil producing countries as an instrument of foreign policy — despite the evidence that they don't work -- and the adverse tax treatment of foreign source income of U.S. oil and gas companies.

— Refinery Capacity and Utilization. Even if we obtain all the oil we need, our energy supply would still be under an enormous strain. While environmental requirements now in place are giving us the most environmentally-sensitive fuels ever manufactured, these requirements have drastically reduced refinery flexibility and further tightened the U.S. supply situation.

The U.S. refinery system is basically maxed out. Capacity utilization averaged 92.6 percent in 2000. At peak levels of seasonal demand, it topped 95 percent. This compares to an average capacity utilization rate in other industries of 82 percent. Refinery capacity utilization is high because our capacity is below what it was 20 years ago. Recent increases have not kept up with the growth in demand — so we've had to import products. But we cannot import much more, because tightening fuel specifications and the proliferation of so-called boutique fuels make it much more difficult for foreign producers to meet the U.S. demand for refined products.
-- **Regulatory Burden.** Increased regulation of fuels and refineries is a major reason why refinery capacity has not kept up with demand. We haven't built a major new refinery in this country in 20 years. Moreover, complex, time-consuming permitting requirements greatly limit the ability of refiners to increase capacity. They also inhibit efforts to increase pipeline capacity. The pipeline system in the U.S. was designed decades ago to handle some 70 percent of liquid fuel transportation, but the increased demand and proliferation of fuels is making this system increasingly inadequate.

-- **Boutique Fuels.** The Clean Air Act Amendments require state implementation plans (SIPs) under which individual metropolitan areas can create their own fuels to meet clean air requirements. There are 15 different types of gasoline now in use because of clean air requirements. This balkanization of fuels greatly reduces refinery flexibility. The reduced flexibility means that relatively minor disruptions and down-time for maintenance can have a much more disruptive impact on the flow of supply.

**Natural Gas**

Natural gas is a clean, safe, efficient and reliable fuel. Consequently, demand is rising, particularly as the fuel of choice for new power plants. Approximately 85 percent of the natural gas consumed in the U.S. is produced domestically. Most of the remainder comes from Canada. The landmark natural gas study issued a year ago by the National Petroleum Council - a DOE advisory committee - projected that producers would have to invest about $658 billion between 1999 and 2015 to meet the growth in gas demand.

The growing demand for natural gas underscores the urgent need for increased access to potentially gas-rich government lands. However, most government lands with the best prospects for new gas discoveries are off limits to development: 100 percent of resources offshore on both coasts; 56 percent of the eastern Gulf of Mexico resources; and 40 percent of the Rocky Mountain region resources.

**Needed: A National Energy Policy**

What is needed from government decision-makers is a serious effort to address U.S. energy problems and shape a fair and effective national energy policy. That is why API welcomes the energy policy initiatives now underway in both Congress and the Administration. However, it took some 25 years to get into today's energy situation - and the problems will not be solved overnight. So it is extremely important that energy be fully represented at the government decision-making table and that the energy impact of environmental and other decisions be fully considered.

After more than two decades of inaction, the American public can no longer afford the luxury of not coming to grips with U.S. energy needs, while maintaining a clean environment. The nation can do both. Meeting U.S. energy needs and protecting the environment are both critical to our nation's continued economic growth - and to achieving the future prosperity and well-being we all seek.
Available Administrative Actions on National Energy Policy in the Oil and Natural Gas Sectors:

Require Executive Branch agencies to avoid significant adverse energy consequences in proposing regulatory and other administrative actions.

Require Executive Branch agencies to review existing rules and policies and revise them as necessary to eliminate significant adverse energy consequences.

Make energy policy a key assignment for a senior White House aide.

Direct the Interior Department, in consultation with other federal land management agencies and the Energy Department, to complete the inventory of federal oil and natural gas resources mandated by the 2000 amendments to the Energy Policy and Conservation Act.

Direct the Energy Department, in consultation with the federal public land management agencies, to identify administrative barriers to timely exploration and development of federal oil and gas resources and take steps to remove those barriers.

Provide a "strike force" to complement existing staff of public land management agencies to immediately reduce the tremendous backlog of pending applications for permits to develop federal oil and gas leases, to revise resource management plans, and to complete required environmental analyses. Ultimately, provide adequate staffing/resources to maintain and expedited timetable for these activities.

Direct the Interior Department to expand royalty-in-kind (RIK) programs onshore and offshore, with any RIK oil to be transferred into the Strategic Petroleum Reserve.

Maintain the December 2001 schedule for OCS Lease Sale 181.

Grant California's request to the Environmental Protection Agency for a waiver from the Clean Air Act's oxygen mandate for reformulated gasoline.

Ensure that the first annual report from the advisory group to EPA on technological feasibility (equipment and construction resources) of the on-road diesel sulfur rule includes meaningful conclusions and recommendations that the agency can use quickly to decide whether modifications should be made to avoid adverse fuel supply and price consequences.

Direct the Labor Department, in consultation with the Energy Department, to develop recommendations for a job-training program designed to fill employment needs in the oil and natural gas industry.

Direct the Office of Management and Budget to determine whether fiscal 2001 funds could be reprogrammed to increase grants to states for low-income heating and weatherization assistance.

Direct OMB to determine whether funds could be reprogrammed to ensure full funding of U.S. Coast Guard nautical charting programs and Corps of Engineers harbor maintenance activities to ensure that tankers can move needed petroleum products safely and expeditiously.
Hi, Joe. As we discussed, attached are a set of papers on national energy policy recommendations. Much of it is designed to be self-explanatory.

The last document is a suggested executive order to ensure that energy implications are considered and acted on in rulemakings and other executive actions. This draft has DOE as the coordinator. Probably also need to make energy a major portfolio item for a senior White House aide.

Let me know if you have questions or additional info needs. Thanks.

Jim Ford
682-8210
fordj@api.org <mailto:fordj@api.org>
RECOMMENDATIONS FOR A NATIONAL ENERGY POLICY

The United States is approaching the end of a year in which consumers have experienced a heating oil price spike followed by a gasoline price spike and higher prices for all petroleum products due to significantly higher crude oil prices, and, most recently, escalating prices for natural gas. These fuel supply challenges facing the United States over this past year are only the most recent reminders that our nation has fallen far short of addressing our energy needs in a sustainable, strategic fashion.

At the same time that energy usage continues to rise, the industry's capability to meet energy demands faces increased limitations that make supplying the marketplace ever more difficult. U.S. crude oil production peaked in 1970 at 9.6 million barrels per day (B/D). Over the first six months of 2000 it has averaged 5.9 million B/D – 39% less than 30 years ago. In the face of tremendous demand, U.S. production of natural gas declined 14 percent between 1973 and 1999. The recent natural gas study by the National Petroleum Council projects that producers will have to invest about $650 billion in upstream capital between 1999 to 2015 to meet the growth in natural gas demand. U.S. refinery utilization is at historically high levels, nearly 96 percent for the third quarter of this year, while refinery capacity has declined from a high of 18.6 million barrels per day in 1981 to 16.5 million barrels per day in 2000, leaving no room for continued economic growth.

If we are to continue America's economic growth and continue creating jobs and wealth across the country, we must have the affordable, reliable energy that fuels our economy and supports our way of life. Congress must develop cost-effective mechanisms for increasing domestic supply. At the same time, environmental concerns must be addressed, and these can be best dealt with through free-market-based incentives, which provide the best foundation for cost-effective solutions. While the U.S. has a strong strategic and economic interest in a vibrant domestic oil and gas industry, we also need a wide diversity of international supplies. Recognizing that 90 percent of the world's proven oil reserves are in the hands of national oil companies, and more than two-thirds of those are in the volatile Middle East, U.S. energy security is best served by U.S. companies being competitive participants in the international energy arena. The recommendations that follow address each stage of oil and gas supply – both domestic and foreign: exploration and production, processing and refining, transportation and distribution. If adopted, they will enhance a strong, productive U.S. energy infrastructure that can supply abundant, affordable energy in an environmentally responsible manner.
UPSTREAM ISSUES

• COASTAL ZONE MANAGEMENT ACT AND OFFSHORE E&P

16 U.S.C. § 1452 states that in administering their coastal zone programs, states shall give priority consideration to the siting of energy facilities associated with the exploration, development, and production of the mineral resources of the Outer Continental Shelf. Yet, U.S. Department of Commerce administration of consistency determinations under the Coastal Zone Management Act has made the law a tool for unnecessary delay and duplicative regulation of offshore exploration and production. For example, the regulations impose consistency determinations on the Interior Department’s Minerals Management Service’s five-year OCS plans and other pre-leasing activities that have no direct impact on a state’s coastal zone.

Recommendation: Amend the Coastal Zone Management Act to ensure that valid offshore natural gas and oil lease rights are protected in the CZMA process and direct the Department of Commerce to administer state consistency programs to ensure priority consideration is given to responsible oil and natural gas development in state consistency determinations.

Reaffirm the primary authority of the Minerals Management Service under the Outer Continental Shelf Lands Act and the National Environmental Policy Act for regulating offshore oil and gas leasing, exploration, development, and production activities and assure that other federal agencies and state agencies do not impose duplicative requirements.

• ARCTIC NATIONAL WILDLIFE REFUGE

Open the Coastal Plain of the Arctic National Wildlife Refuge (ANWR) to oil and natural gas exploration and development. ANWR is America’s most promising area for the discovery of giant oil and gas resources in North America.

Recommendation: The Alaska National Interest Lands and Conservation Act 16 USC Sec. 3101 et seq. provides for development of oil and natural gas resources from ANWR upon an affirmative vote of both the House of Representatives and the Senate.

• DEEPWATER ROYALTY RELIEF

To encourage investment in domestic oil and gas resources on the Outer Continental Shelf, Congress enacted the Deepwater Royalty Relief Act of 1995 to suspended the payment of royalties for specific initial quantities of oil and gas produced from the OCS in water depths greater than 200 meters. This incentive was very successful and resulted in billions of

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dollars in additional revenue to the United States and a significant increase in oil and natural gas production of from OCS waters.

**Recommendation:** Amend Title III of Public Law 104-58, "Alaska Power Administration Sale Act," Section 304, to permanently adopt the deepwater royalty relief automatic suspension volume provisions that expired November 2000 for all deepwater production.

- **ROYALTY IN KIND**
  The Minerals Management Service's recent RIK pilot projects in Wyoming, Gulf of Mexico and in Texas state waters have successfully demonstrated the Agency's ability to take royalties in kind, rather than value. RIK saves the taxpayer money through reduction in administrative costs and reduction of the uncertainty inherent in paying royalties in value that often results in costly agency and court disputes.

**Recommendation:** Amend the Outer Continental Lands Act, 43 USC Sec. 1331 et seq. and the Mineral Leasing Act of 1920, 30 USC Section181 et seq. to promote RIK wherever practicable and clarify that the MMS' existing authority to use RIK includes the authority to pay transportation and other post-production costs.

- **SAFE DRINKING WATER ACT**
  Hydraulic fracturing is a vital technology that is used in over half of the natural gas wells in the country. Current litigation over the regulation of this activity could dramatically increase the cost of this technology and limit natural gas production in some areas of the country. Clarification is needed for the Safe Drinking Water Act's underground injection control provisions to exclude coverage of hydraulic fracturing. This would allow states to continue to regulate hydraulic fracturing under their oil and gas regulatory programs.

**Recommendation:** Amend Section 1421(d)(1) of the Safe Drinking Water Act (42 U.S.C. 300h(d)) to clarify that the term underground injection does not include hydraulic fracturing similar to S. 724 in the 106th Congress.

- **STRATEGIC PETROLEUM RESERVE**
  The Strategic Petroleum Reserve was created by Congress to provide for limited supplies of oil in time of supply disruptions, thereby enhancing national security. In 1998, when oil prices were low, the Secretary of Energy used federal royalty oil taken in kind by the Minerals Management Service and transferred to DOE for filling the SPR. This is a practice that should be strongly encouraged.

**Recommendation:** Amend Part B of Title I of the Energy Policy and Conservation Act (42 U.S.C. § 6232 et seq.) to strongly encourage the
Secretary of Energy to fill the Strategic Petroleum Reserve during periods of stable oil prices to the equivalent of 90 days of imports for use in national emergencies only, using federal royalty oil, taken in-kind.

UPSTREAM ISSUES REQUIRING CONGRESSIONAL OVERSIGHT

• ACCESS TO GOVERNMENT LANDS FOR NATURAL GAS AND OIL DEVELOPMENT

In developing a National Energy Policy, Congress should direct the Administration, perhaps in oversight hearings, to adhere to existing congressional mandates under the Federal Land Policy Management Act and related Acts requiring agencies to give balanced consideration to multiple competing uses of federal land. Oil and natural gas development is an important use of federal lands and experience has shown that it does not have to be excluded for environmental or aesthetic purposes.

Direct the U.S. Forest Service and the Bureau of Land Management to revise their planning regulations to make natural gas and oil leasing a priority. For example:

Recommendation: Direct the Administration to conduct a thorough and comprehensive review of offshore leasing moratoria, allowing leasing and production of natural gas and oil in all but the most sensitive environmental areas.

Recommendation: Direct the U.S. Forest Service and the Bureau of Land Management to revise their resource planning regulations to make natural gas and oil leasing a priority in order to meet the Nation’s critical energy needs.
DOWNSTREAM ISSUES

FEDERAL OXYGEN MANDATE AND MTBE

The Clean Air Act mandates a minimum amount of oxygen in federal reformulated gasoline. This requirement indirectly requires the use of oxygenates such as MTBE and ethanol. The oxygen mandate is becoming environmentally obsolete and should be repealed so refiners can reduce the use of oxygenates in the most cost-effective manner. Consumers are best served when refiners have the flexibility to blend gasolines that meet federal and state environmental requirements and vehicle needs. Mandates that prescribe a recipe for gasolines constrain the nation's fuel production and usually result in increased refiner and consumer costs, as demonstrated by the outcry over the price and supply problems caused by the required introduction of a new reformulated gasoline in the Midwest this past summer.

Recommendation: Legislation is needed for a waiver of the oxygen content requirement for reformulated gasoline as follows:

Section 211(k)(1) of the Clean Air Act (42 U.S.C. 7545(k)(1)) is amended—

(1) by striking "Within 1 year after the enactment of the Clean Air Act Amendments of 1990," and inserting the following:

"(A) IN GENERAL- Not later than November 15, 1991,"; and

(2) by adding at the end the following:

"(B) WAIVER OF OXYGEN CONTENT REQUIREMENT-

(i) IN GENERAL- Notwithstanding any other provision of this subsection, upon notification by the Governor of a State to the Administrator, a Governor may waive paragraphs (2)(B) and (3)(A)(v) with respect to gasoline sold or dispensed in the State.

(ii) TREATMENT AS REFORMULATED GASOLINE - In the case of a State for which the Governor invokes the waiver described in clause (i), gasoline that complies with all provisions of this subsection other than paragraphs (2)(B) and (3)(A)(v) shall be considered to be reformulated gasoline for the purposes of this subsection."
• **DOWNSTREAM REGULATORY ENVIRONMENT**

Oil and natural gas will continue to be the most versatile, affordable and abundant fuels for the foreseeable future. Their use is critical to sustaining U.S. economic prosperity and is compatible with environmental goals. At the same time, the nation's energy infrastructure is near capacity and significant expansion will be needed over the next twenty years. The energy impacts of administrative actions must be considered in order to create a climate that encourages capacity expansion and provides the necessary certainty enabling capacity expansion to occur in a sensible and cost effective manner.

**Recommendations:** The following items need to be incorporated into energy legislation:

- Administrative actions impacting energy supply and conservation must rely on sound science and the application of full cost-benefit and risk analyses and should be performance-based.

- Certainty in scope, timing, requirements and interpretation are needed so that necessary capital improvements can be made with the knowledge that further changes will not result in wasted investment.

- The permitting process must be streamlined where possible to ensure that capacity expansions are not delayed, and state and local agencies should provide the necessary resources to process permits expeditiously.

- Refiners must have a minimum of 4 years lead time for finalization of requirements for implementation of a significant refinery investment.

- Administrative actions should be consistent with sound business practices, and deadlines for meeting new requirements should be based on costs, benefits and practicality.

- Measures should be coordinated to avoid overlap or conflict and companies should be provided adequate time to recover capital costs before additional controls are imposed.

- Requirements should be better defined and consistently applied. Increasing capacity to produce more fuel to satisfy growing demand is impeded by the uncertainty introduced by complexity, lack of clarity and retroactive reinterpretation. Punitive, selective and unpredictable enforcement policies discourage and unfairly penalize sound
compliance efforts (e.g., EPA New Source Review enforcement initiative).

- The energy implications of all federal government actions should be explicitly identified and considered before a law or regulation is enacted. These actions should be carefully reviewed in light of their energy implications and rejected if their adverse impact on energy supplies is not justified by the other benefits.

- **ASSURING ADEQUATE AND AFFORDABLE FUELS**
  The National Petroleum Council published a study in June 2000 entitled "U.S. Petroleum Refining – Assuring the Adequacy and Affordability of Cleaner Fuels." The study assessed government policies and actions that would affect product supply and refinery viability. The study concludes that the refining and distribution industry will be significantly challenged to meet the increasing domestic light petroleum product demand with the substantial changes in fuel quality specifications recently promulgated and currently being considered.

The NPC study contains specific recommendations and finding related to petroleum product supply and future refinery viability. The Secretary of Energy, in consultation with the governmental departments and federal agencies, shall report to the applicable committees in the houses of Congress on the findings and conclusions of the NPC study and on the adjustments to federal policy required to implement those findings and conclusions. This report shall include but not be limited to the following:

- Policy changes needed within federal departments and agencies to implement the findings and conclusions of the NPC study
- Identification of needed changes that cannot be accomplished through Executive Branch action alone; and recommendations that, if passed and signed into law, would accomplish the changes needed.

- **RESTRICTIVE PETROLEUM MARKETING LEGISLATION**
  Congress should refrain from introducing any petroleum marketing legislation that interferes in the contractual arrangements between suppliers and their customers. This type of legislation injects inappropriate and unwarranted governmental controls on the marketplace and often has unintended consequences.

  **Recommendation:** Reject any proposals that comprehensive NEP legislation include marketing restrictions.
MARINE TRANSPORTATION ISSUES

- Support increased marine-related funding for the Army Corps of Engineers (dredging), and NOAA (nautical charting). Congress should direct NOAA to develop a plan to eliminate the backlog of hydrographic survey data within five years.

The safe and efficient movement of goods through the United States’ port system, including crude oil and petroleum products, requires that channels be dredged and maintained at safe depths on a consistent basis.

Recommendation: Among all the marine infrastructure activities, dredging programs which facilitate commerce must be given a priority for funding, and such funding must continue even while the harbor maintenance tax issue is discussed and debated.

Safe navigation also requires accurate and current navigational charts for U.S. waterways. To date, however, these programs have been and continue to be so severely underfunded that it will take the National Oceanic and Atmospheric Administration (NOAA) 20 years to eliminate the survey backlog. Hydrographic survey data, which is the basis for nautical charts, should be collected using the latest hydrographic survey equipment. Some hydrographic data still being used is over 40 years old. All available resources, both public and private, should be fully utilized, without limits placed on the sources of certifiable survey data.

Recommendation: Funding for this effort should be increased so that the survey backlog can be eliminated in the shortest possible timeframe consistent with sound resource allocation and management principles.

- Take the Harbor Maintenance Fund off budget and earmark it exclusively for harbor services.

An off budget trust fund, which is not subject to annual appropriation, is critical to ensure that funds are consistently available for meeting marine infrastructure needs and that funds collected for that purpose are not diverted to any other program. The Harbor Maintenance Trust Fund should be taken off budget and used exclusively for harbor services. This would guarantee resources are available to meet the growing needs of maritime commerce.

Revenue earmarked for the Harbor Maintenance Trust Fund should be obtained from a variety of sources. Because of the broad benefits provided by the United States’ waterways, general revenues should contribute to the trust fund in large measure. A user fee covering a portion of harbor maintenance costs is also acceptable if: the fees are paid by all beneficiaries, the size of fees are commensurate with the cost or value of the service rendered, and the beneficiaries have input into prioritization and fund allocation.
**Recommendation:** Enact H.R. 111 of the 106th Congress to accomplish these purposes.

- Provide the U.S. Coast Guard with adequate funding to preserve its leadership role within the International Maritime Organization (IMO). Congress should clarify that the Coast Guard has the authority to develop US positions and represent the US before the IMO.

A national energy policy needs to recognize the international nature of oil transportation. Accordingly, the US government should look to and support broad-based international solutions to marine regulatory issues. The International Maritime Organization (IMO) is the appropriate forum for discussions of such issues as vessel operations, ballast water management, marine air emissions, and vessel scrapping.

**Recommendation:** As the U.S. representative to IMO, the US Coast Guard should be provided the resources necessary to fulfill its role and to provide leadership within IMO as a prominent national maritime authority.

- Reform the Jones Act and permit ships built in foreign countries to engage in coastwise trade transporting crude oil and petroleum products.

The US needs to remove barriers to the timely replacement of aging domestic tonnage and stimulate a robust domestic fleet.

**Recommendation:** This can be accomplished by S. 1032 of the 106th Congress to reform the build America-only provisions of the Jones Act for large, ocean going, self-propelled tankers.