INTERSTATE: NATURAL GAS - PETEROLEUM
EMERGENCY H.R. 11450 HOS

MOSS, JOHN E.

JOHN E. MOSS
3RD DISTRICT
SACRAMENTO, CALIFORNIA

ADMINISTRATIVE ASSISTANT
JACK MATTESON

file

WASHINGTON OFFICE:
LEGISLATIVE ASSISTANT
EUGENE A. BROWN
ROOM 2185
RAYBURN HOUSE OFFICE BUILDING
PHONE (202) 225-7163

DISTRICT OFFICE:
DISTRICT REPRESENTATIVE
JERRY WYMORE
8058 FEDERAL BUILDING
650 CAPITOL MALL
SACRAMENTO, CALIFORNIA 95814
PHONE (916) 449-3543

CONGRESS OF THE UNITED STATES

HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

GOVERNMENT OPERATIONS COMMITTEE:
RANKING MAJORITY MEMBER SUBCOMMITTEES ON
FOREIGN OPERATIONS & GOVERNMENT INFORMATION
CONSERVATION & NATURAL RESOURCES

INTERSTATE AND FOREIGN COMMERCE COMMITTEE:
CHAIRMAN,
COMMERCE & FINANCE SUBCOMMITTEE

DEMOCRATIC STEERING AND POLICY COMMITTEE

February 15, 1974

FEB 19 1974

To The Conferees on the Emergency Energy Act:

I am enclosing for your information an exchange of correspondence between myself and William E. Simon regarding the administration by the Federal Energy Office of Section 4 of the Emergency Petroleum Allocation Act requiring "equitable prices ... among all users".

I have found it difficult to comprehend Mr. Simon's interpretation of this Congressional requirement.

Mr. Simon's understanding of the requirement of existing law bears directly on the need for enactment of the Emergency Energy Act, particularly Section 110 dealing with petroleum product prices.

Best regards.

Sincerely,

John E. Moss

JOHN E. MOSS, M.C.

JOHN E. MOSS
3RD DISTRICT
SACRAMENTO, CALIFORNIA

ADMINISTRATIVE ASSISTANT
JACK MATTESON

WASHINGTON OFFICE:
LEGISLATIVE ASSISTANT
EUGENE A. BROWN
ROOM 2354
RAYBURN HOUSE OFFICE BUILDING
PHONE (202) 225-7163

DISTRICT OFFICE:
DISTRICT REPRESENTATIVE
JERRY WYMORE
8058 FEDERAL BUILDING
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DEMOCRATIC STEERING AND POLICY COMMITTEE

February 15, 1974

Honorable William E. Simon
Administrator
Federal Energy Office
Washington, D. C.

Dear Mr. Simon:

On January 4, 1974, I addressed a series of questions to you regarding the pricing provisions of the Emergency Petroleum Allocation Act. I did this because of my grave concern over public statements by your office that the price of gasoline would be permitted to increase an additional 10¢ per gallon by March 1974. This increase would be in addition to price increases which already had occurred on that date, approximating 10¢ per gallon.

The crucial question that I posed to you on January 4, was as follows:

> Section 4 of the Emergency Petroleum Allocation Act requires "equitable prices" to consumers for petroleum products. Please describe the procedures by which your office has determined that this statutory requirement has and will be met with regard to these price increases. In addition, please advise me whether you find the projected increased price levels "equitable" to consumers as required by the Act.

On February 15, 1974, after repeated requests to your office, I received a response to the above inquiry as follows:

> "Describe the procedures to meet the requirement for equitable prices to consumers in Section 4 of the Emergency Petroleum Allocation Act.
>
> Our regulations require that increased costs attributed to a product be applied equally to each purchaser in a class of customers purchasing that product. In other words, if the price of a product is increased by 5% for that class of purchaser, it is increased by 5% to each customer within the class purchasing that product to ensure "equitable prices" to all consumers of that product. The auditing of regular reports required to be submitted to FEO on prices and checks by Internal Revenue Service agents ensure that the price increases are applied on an equitable basis. Because of audits and checks, often in response to complaints by buyers who suspect illegal pricing, we believe this will continue to be true. A detailed explanation of the joint FEO-IRS Refinery Audit and Review Program (RARP) is attached as Appendix I." (emphasis added)

I am shocked that your response indicates a complete lack of understanding of the Congressional requirements incorporated in section 4(b) of the Emergency Petroleum Allocation Act. That section provides "The regulation. . .shall provide for (F) equitable distribution of crude oil, residual fuel oil, and refined petroleum products at equitable prices among all regions and areas of the United States and sectors of the petroleum industry, including independent refiners, small refiners, nonbranded independent marketers, branded independent marketers, and among all users;". It appears that you construe this crucial provision of the Act as requiring only that increased costs be applied equally to each purchaser within a class of purchasers. I find not a word in your response to indicate that the requirement of "equitable prices" imposes upon FEO the obligation to insure that the ultimate price level charged to all consumers is fair.

The legislative history is clear on this subject. The House Report states:

> "The reference to equitable prices in paragraph (E) is intended to emphasize that the objectives of the mandatory allocation program are to prevent price gouging or price discrimination which might otherwise occur on the basis of current shortages. It is expected that prices for allocated fuels will be set at levels or pursuant to methods which will permit adequate compensation to assure that private property is not implicitly confiscated by the government. Moreover, it is expected that the President in exercising this authority will be conscious of the need to determine prices which equitably balance the objectives of obtaining adequate supply and holding down consumer costs." (House Rep. 93-531, p. 19)

Rather than equitably balancing the objectives of adequate supply and holding down consumer costs, you appear to be administering the statute in a manner calculated to pass on to the consuming public any and all burdens of the energy shortage and to permit a pass through of all costs together with sharply increased profit margins. If this interpretation of your position is correct, it is incumbent on the Congress to promptly enact the Emergency Energy Act (S. 2589) because the price rollback provision of Section 110 will at least require a rollback of domestic oil to approximately $5.25 per barrel and a detailed analysis to the Congress and the American people of the basis for any price increases above that level. Surely the public is entitled to such reassurance that it is not bearing the full cost of the energy shortage.

I look forward to any response you may wish to furnish.

Sincerely,

John E. Moss
Chairman
Subcommittee on
Commerce and Finance

JEM:la

cc: Conferees on the Emergency Energy Act

FEDERAL ENERGY OFFICE
WASHINGTON, D.C. 20461

OFFICE OF THE ADMINISTRATOR

February 6, 1974

Moss

The Honorable John E. Moss
Chairman
Subcommittee on Commerce and Finance
House of Representatives
Washington, D. C.

Dear Congressman Moss:

In response to your letter of January 4, 1974, regarding Congressional consideration of the Emergency Energy Act, I have asked our office of Price and Tax Policy to provide answers to your seven questions. If we can be of further assistance to you and your committee, please feel free to contact me. Answers to your questions follow.

Press reports indicate projections of a 10¢ per gallon increase in the price of gas, diesel fuel, and home heating oil by March.

The projection of a possible 10¢ per gallon increase in the price of gasoline, diesel fuel and home heating oil by March was based on a number of factors. Primarily, the anticipated increase will reflect the sharply higher (as much as 400%) cost of imported crude oil as well as higher costs for imported petroleum products. Other factors are the higher cost of domestic crude oil; the one-time increase in wholesale and retail prices of these products allowed by FEO in January to cover increased non-product costs; expected additional pricing adjustments at retail and wholesale to offset reduced product availability to individual businesses due to mandatory allocation and the Government's efforts to reduce gasoline production in favor of increased distillate production. A detailed explanation of all these factors follows:

(a) On December 19, 1973, the Cost of Living Council, after consulting with me and other government officials, permitted an increase of $1.00 per barrel in the ceiling price of domestic crude petroleum subject to price controls -- that is "old" oil under CLC, and now FEO, definitions. This action directly affected approximately 75% of the crude produced in this country. The remaining 25% is exempt from price controls and consists of "new" oil (that amount of oil produced above 1972 levels on each property), released oil (one barrel of "old" oil is released from price control for each barrel of "new" oil produced from a property that was producing in 1972), and stripper well oil (oil produced from leases which averaged 10 or less barrels per day production in the previous year). As you know, in November 1973, Congress exempted stripper well oil from both price controls and allocation. However, because prices of uncontrolled oil ("new", released and stripper) are most often tied to the posted prices of "old" oil, the prices of uncontrolled oil increased by about $1.00 as a result of the December 19th action of the CLC. Since prices for uncontrolled domestic oil have increased further reflecting the sharp increases for imported oil.

The crude oil price adjustment of $1.00 per barrel translates into roughly a 2.3 cents per gallon increase in retail prices for gasoline, home heating oil and diesel fuel.

	Retail Increases (per gallon)
	2.3¢

(b) On January 1, 1974, the FEO permitted sellers of gasoline, home heating oil and diesel fuel to increase their prices to offset increased non-product overhead costs. Retailers are allowed to increase their prices by 1 cent per gallon and wholesalers are allowed to increase their prices by ½ cent per gallon. One cent for retailers and ½ cent for wholesalers means price increases of 1.5 cents per gallon at retail. This is true because once each month retailers are allowed to pass on to their customers increases in wholesale prices.

1.5¢

(c) After consultation with the Retail Dealers Group, the FEO will announce shortly a price adjustment system to allow retailers and wholesalers adjustments in their prices to partially recoup revenues lost due to reduction in the amount of gasoline they have to sell under the Mandatory Allocation Program. The Retail Dealers Group is now being formed as an advisory group to FEO to provide expert information on the petroleum retail business. With both retailers and wholesalers allowed to increase their prices under this system, it is expected to mean about a 2 cents to 3 cents increase at retail.

2¢ - 3¢

(d) Further, the prices of all petroleum products will continue to escalate through February due to the massive price increases for imported crude and products effective this month. It is more difficult to quantify what these recent increases for foreign oil will mean at retail for two reasons: the question as to the effectiveness and length of the Arab embargo; and, the differing import mixes and characteristics of the U. S. companies that import both crude oil and petroleum products. These companies import various kinds, quantities, and mixes of different crude oils and products at varying prices. Thus, it is difficult to predict what the aggregate price impact will be of general increases in the prices of foreign crudes. However, depending on these multiple variables, we expect the foreign price increases to mean between a 2 cent to 4 cent increase at retail, generally, with some possible exceptions outside that range.

2¢ - 4¢

Total: 7.8¢ -10.8¢

(e) Increases for heating oil and diesel fuel could possibly be larger by 2 cents to 3 cents per gallon, due to Steps 1 and 2 of the Refinery Balance Incentive Program effective January 1, 1974. The first step called for a 2¢ increase in distillate fuel prices and a corresponding decrease in gasoline prices (about 1¢) to remove the price incentive for refiners to produce gasoline as opposed to distillates (e.g., home heating oil and diesel fuel). This was done to increase distillate production so vital for homes and industry, especially at this time of year. Step 2 allowed for further modest increases in distillate price to offset revenues lost due to refiner efforts to shift refinery yields as far as reasonable away from gasoline toward increased distillate production. None of the above price increases will result in increased profits to the firms involved.

Describe the procedures to meet the requirement for equitable prices to consumers in Section 4 of the Emergency Petroleum Allocation Act.

Our regulations require that increased costs attributed to a product be applied equally to each purchaser in a class of customer purchasing that product. In other words, if the price of a product is increased by 5% for that class of purchaser, it is increased by 5% to each customer within the class purchasing that product to ensure "equitable prices" to all consumers of that product. The auditing of regular reports required to be submitted to FEO on prices and checks by Internal Revenue Service agents ensure that the price increases are applied on an equitable basis. Because of the audits and checks, often in response to complaints by buyers who suspect illegal pricing, we believe this will continue to be true. A detailed explanation of the joint FEO-IRS Refinery Audit and Review Program (RARP) is attached as Appendix 1.

What was the basis for the 1¢ increase to retail fuel dealers?

The 1¢ increase was granted to retail dealers rather than to wholesalers. The increase covered increased costs of labor, taxes (including real estate), utilities, maintainance, supplies and the like which these small businessmen had incurred since May 15, 1973. The figure was carefully calculated on the basis of industry-wide accounting figures, but individual retailers were also checked either through voluntary submission of their own data or through IRS spot surveys. A flat 1¢ increase was selected rather than allowing for individual increases to reflect increased costs because the latter would be too difficult to monitor and enforce. Estimates of the number of retail and wholesale gasoline, home heating oil and diesel fuel operations range up to 500,000. Refiners who wholesale and/or retail do not receive either increase automatically, but must provide detailed cost justification for such increases before the FEO will allow them.

Please explain the large increase in the cost of foreign oil.

Price of imported oil is not controlled by FEO. The current cost of foreign oil has had, as discussed above, a significant impact on increased costs to consumers. The U.S. is now dependent upon imports to a large extent. For the first nine months of 1973, 25.78% of the crude consumed in the United States was imported. This is a significant increase over all of 1972 when 18.27% of the crude processed for domestic use was imported. Product imports have also increased. Distillate fuel oil imports rose from 6.23% of total use in 1972 to 11.91% of total use in the first nine months of 1973. The country has relied on imported residual oil for a major portion of its use for some years. In 1972, imported residual oil accounted for 68.86% of total use and in the first nine months of 1973 for 66.64% of total use.

The price increase of between 2¢ and 4¢ mentioned in the estimate applied to the increased cost of imported crude oil and product. As indicated above, other costs are related to the increased costs of domestic crude oil and other operating costs.

Many refineries with foreign producing subsidiaries purchase crude oil from those subsidiaries. The exact amount would depend on the specific refiner and its contractual relationship to the subsidiary. Such arrangements tend to ensure a source of supply for the domestic refiner and the price charged is almost always well below the price the refiner would have to pay on the open market, therefore decreasing the potential cost to the consumer. The domestic refiner may or may not be the controlling entity. In addition, the FEO and IRS audit procedures (RARP) mentioned above and described in Appendix 1 is designed to prevent artificial "deals" involving resellers, class of customers, processing arrangements, profiteering or other attempts to circumvent price regulations. Civil penalties of $2,500 and criminal penalties of $5,000 for each violation can be imposed. Of course, legal price increases can be passed on by the refiner.

Please explain the increased costs to retailers based upon the decreased volume of available supply.

Our Refinery Balance Incentive Program is designed to increase the production of distillates resulting in a decrease in the production of gasoline. Since this governmental action could possibly adversely impact on the earning capacity of independent gasoline retailers we are currently studying both the feasibility and propriety of providing relief to these retail service station operators. The proposals being studied would not increase their total profits beyond pre-allocation levels but would allow adjustments in their profit margin per gallon to offset the loss of revenue which might result from governmental action to encourage refiners to produce more distillate.

Please comment on the charge that Sun Oil Company is charging excessive prices for heating oil in New England.

The allegation that Sun Oil Company has sold heating oil in New England to independent distributors at prices above those charged its own distributors has been under recent review. The cargo sales in question, primarily No. 2 fuel oil and also some kerosene, were sold by Sun Oil Company's Puerto Rican subsidiary, Puerto Rico Sun Oil Company, to East Coast terminal operators at spot market rates in November and December of 1973. The three transactions involved occurred on the dates of November 6, 1973; November 25, 1973; and December 29, 1973. It was not, however, until December 27, 1973, pursuant to the provisions of the Emergency Petroleum Allocation Act of 1973 that petroleum price controls were extended to Puerto Rico. Consequently only the December 29 transaction actually fell within the scope of the FEO Petroleum Price Regulations. However, by an agreed order of the FEO, Sun Oil Company will charge a price for the three cargo shipments in question no higher than that permitted under the FEO Petroleum Price Regulations (10 CFR, Section 212.83). Further Sun Oil Company is to furnish documentary cost information to justify prices charged in these transactions, while the terminal operators involved shall rebate to their customers the savings realized and shall likewise provide satisfactory evidence of their compliance with the FEO order.

Describe the source and nature of financial data used by FEO to arrive at permissible increased costs.

The Cost of Living Council and now the Federal Energy Office requires submission of complete financial data on costs and price increases on a regular basis from all but the smallest companies involved in the production, refining and sale of crude or petroleum products. In addition, periodic field audits conducted jointly by the FEO and IRS are made of the 26 largest refiners and desk audits are conducted on smaller refiners. The Refinery Audit and Review Program was designed to ensure that petroleum product price increases are justified and reflect only increased costs to refiners for imported and domestic petroleum supplies and not increased profits. The program will also give FEO means to verify the accuracy of refiner reports on crude oil and product supplies and is a major step toward establishing an independent reporting and information system on refinery inventories at FEO. The audit task force is divided into teams that will be conducting continuing audits in corporate offices, visiting individual firms as often as four times a year. The teams consist of FEO cost analysts and IRS agents who have been trained in FEO petroleum regulations and are experienced in refinery accounting practices.

FEO regulations permit a refiner to adjust prices once a month but only to reflect increased costs for crude oil (foreign and domestic) or refined products purchased for resale. Refiners must reflect these increased costs through uniform application of price increases to particular types of products. The refiners must also report cost jstification calculations to the FEO each month to support their price increases, and they are not allowed to carry excessive inventories.

A basic reporting form is the CLC (FEO) Form 90 which must be filed monthly by companies dealing in crude or petroleum products with \$50 million or more in annual sales or revenues from such products and by all refiners regardless of annual sales or revenues. Firms between \$1 million and \$50 million in annual sales or revenues must prepare the form and retain it at their principal place of business. It covers the selling price and percent change in quantity. The same information is required for buying prices. It identifies data concerning increased costs and problems with supply as well as information on changing prices for "new" crude. Some 1,500 reports are filed monthly.

The CLC (FEO) Form 92 is the notification of price adjustment for No. 2 heating oil which is permitted monthly. If all heating oil dealers increased their prices monthly, it is estimated some 10,000 of these forms would be filed each month.

The CLC (FEO) Form 96 is a monthly report required from all refiners on allocation of increased product costs.

These forms and the instructions for their preparation are attached as Appendix 2. The data from these sources is summarized monthly in the Petroleum Industry Monitoring System (PIMS). PIMS reports are issued monthly by the Office of Price and Tax Policy to provide an on-going monitoring system.

In addition to the field audit teams, some 1,000 IRS agents are available to enforce FEO regulations. These agents have been utilized for nationwide sweeps to determine compliance with price regulations by specific segments of the petroleum industry such as truck stops, for random spot checks for each segment of the petroleum industry, for sweeps of specific regions where reports indicate noncompliance may be widespread and for investigation of individual reports of noncompliance.

Again, if we can provide further information, please contact me.

Sincerely,

SIGNED/WILLIAM E. SIMON

William E. Simon
Administrator