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# Issue Brief for Congress

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## Strategic Petroleum Reserve

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## Strategic Petroleum Reserve

### SUMMARY

Anticipation of a possible confrontation with Iraq has raised fresh concern about oil supply and price, and could raise interest once again in use of the SPR.

The SPR was authorized in 1975 in the Energy Policy and Conservation Act (EPCA) to protect the Nation against a repetition of the economic dislocation caused by the 1973-74 oil embargo. Congressional attention to the SPR declined during the 1990s as a number of developments intersected: (1) the need to cut federal spending; (2) declining likelihood of prolonged and crippling oil supply interruptions; (3) unregulated oil markets that appear to operate efficiently in allocating and pricing oil; and (4) a consensus that the SPR was probably at an adequate level and additional fill was not justified. In 1994, the Clinton Administration and Congress agreed to suspend further purchases for the SPR. Maintaining SPR readiness and upgrading aging infrastructure became the major priority.

The terrorist attacks on September 11, 2001, have renewed concerns about domestic energy security. On October 9, 2001, the House passed a resolution expressing House support for filling the SPR to its full authorized capacity of 1 billion barrels. On November 13, 2001, the President ordered fill of the SPR to its current capacity of roughly 700 million barrels, principally through royalty-in-kind (RIK) acquisitions. The SPR held more than 593 million barrels by the end of November, the highest level of inventory since the program began.

Drawdown of the Reserve can be authorized by the President in the event or likelihood of a "severe energy supply interruption," to meet U.S. obligations to International Energy Agency allies for emergency oil-shar-

ing, or in the event of a shortage that would bring about an increase in petroleum prices sharp enough to have "a major adverse impact" on the economy. The Presidential authority has been used once – in January 1991 – during the Persian Gulf War.

In the 107<sup>th</sup> Congress, the conferees on comprehensive energy legislation agreed to language in the Senate version that would permanently authorize the SPR and require fill to its current capacity of approximately 700 million barrels. However, the 107<sup>th</sup> Congress adjourned without passing the bill.

The FY2003 budget request for the SPR was \$188.8 million, including \$11.0 million to support the costs of transporting RIK oil to SPR sites. However, at the end of the 107<sup>th</sup> Congress, the SPR was funded at FY2002 levels under a continuing resolution.

Crude oil futures rose above \$32/barrel following Christmas, because of concerns over the likelihood of war with Iraq and a general strike that reduced oil exports from Venezuela from 3.1 mbd (million barrels per day) to less than 200,000 b/d. Some are urging that the SPR be tapped to make up for the roughly 1.5 mbd of Venezuelan exports to the United States that have been interrupted. The Administration has indicated that it is watching the situation but that there is no justification yet for drawing down the SPR. In the wake of these tensions in oil markets, some companies still returning oil swapped from the SPR during 2000 have been granted extensions on their remaining oil-return commitments. Deliveries of RIK oil to the SPR will be minimal in January, but could be slowed further or suspended altogether to free more crude for U.S. markets.

## MOST RECENT DEVELOPMENTS

*Crude oil futures rose above \$32/barrel following Christmas, because of concerns over the likelihood of war with Iraq and a general strike that reduced oil exports from Venezuela from 3.1 mbd (million barrels per day) to less than 200,000 b/d. Some are urging that the Strategic Petroleum Reserve (SPR) be tapped to make up for the roughly 1.5 mbd of Venezuelan exports to the United States that have been interrupted. The Bush Administration has indicated that it is watching the situation but that there is no justification yet for drawing down the SPR. In the wake of these tensions in oil markets, some companies still returning oil swapped from the SPR during 2000 have been granted extensions on their remaining oil-return commitments. Deliveries to the SPR of royalty-in-kind oil (the federal share of oil from public lands) will be minimal in January, but could be slowed further or suspended altogether to free more crude for U.S. markets.*

*In November 2002, the amount of crude oil stored in the SPR surpassed its previous all-time high and at the end of December was nearing 600 million barrels. This is partly the consequence of a Presidential order in mid-November of 2001 to fill the SPR to its current capacity of roughly 700 million barrels, principally through oil acquired as royalty-in-kind from federal offshore leases. Under the current schedule, the SPR will not be filled to capacity until 2005.*

*Comprehensive energy legislation (H.R. 4) passed by the Senate on April 25, 2002, included language that would have permanently authorized the SPR and required fill to its current capacity of approximately 700 million barrels. Conferees on the legislation agreed to this provision; however, Congress adjourned without taking final action on the measure. A new bill is expected to be introduced in the 108<sup>th</sup> Congress.*

## BACKGROUND AND ANALYSIS

The anticipation of a possible confrontation with Iraq has already added what is described as a "war premium" to oil prices. Exports of Iraqi oil are currently below 1.0 million barrels daily, an amount which, if lost to world markets, could be made up by other producers with spare capacity. However, uncertainty about how prolonged a military conflict might be, and whether Middle Eastern oil producers would be disposed to keeping prices reined in, may provoke interest in possible use of the SPR to replace supply that might be lost to, or diverted from, U.S. markets.

To help prevent a repetition of the economic dislocation caused by the 1973-74 Arab oil embargo, Congress authorized the Strategic Petroleum Reserve (SPR) in the Energy Policy and Conservation Act (EPCA, P.L. 94-163). Physically, the SPR comprises five underground storage facilities, hollowed out from naturally occurring salt domes, located in Texas and Louisiana. Oil stored at one of the sites, Weeks Island, was transferred after problems with the structural integrity of the cavern were discovered in the mid-1990s.

It was generally believed that the mere existence of a large, operational reserve of crude oil would deter future oil cutoffs and would discourage the use of oil as a weapon. In the event of an interruption, introduction into the market of oil from the Reserve was expected

to help calm markets, mitigate sharp price spikes, and reduce the economic dislocation that had accompanied the 1973 disruption. In so doing, the Reserve would also buy time — time for the crisis to sort itself out or for diplomacy to seek some resolution before a potentially severe oil shortage escalated the crisis beyond diplomacy. The SPR was to contain enough crude oil to replace imports for 90 days, with a goal initially of 500 million barrels in storage. In May 1978, plans for a 750-million-barrel Reserve were implemented.

The program fell increasingly behind schedule. By the end of 1978, the SPR was supposed to contain 250 million barrels, but contained only 69 million barrels. When the Iranian revolution cut supplies in the spring of 1979, purchases were suspended to reduce the upward pressure on world oil prices. Filling of the Reserve was resumed in September 1980 following enactment of the Energy Security Act (P.L. 96-294), which established a minimum fill rate of 100,000 barrels per day (b/d). An amendment to the FY1981 DOE appropriations legislation required that the Administration accelerate the fill rate to 300,000 b/d, subject to adjustments for cost and other market factors. The fill rate was 292,000 b/d in FY1981, but steadily declined to a low of 34,000 b/d in FY1990.

Filling of the SPR was suspended during 1990-1992 after the Iraqi invasion of Kuwait, but was resumed at a modest rate. Fill declined to 16,500 b/d during FY1994 before fill was suspended at the end of that fiscal year. The SPR itself reached 592 million barrels before purchases were again suspended. Owing to sales of SPR oil during 1996, the level in the Reserve had fallen to 563.5 million barrels by the early spring of 1997. (At the prices prevailing in the late spring of 1998, that inventory would have declined to roughly 542 million barrels had a sale authorized for FY1998 been carried out.) In mid-November of 2001, President Bush ordered fill of the SPR to its current capacity of roughly 700 million barrels, principally through oil acquired as royalty-in-kind (RIK) for production from federal offshore leases. At the current rate of fill, the SPR will not be filled to capacity until 2005. At the end of November 2002, the SPR inventory reached over 593 million barrels, exceeding the previous highest level of 592 million barrels.

## **Reauthorization of the SPR**

The authorities governing a drawdown of the SPR are included in the Energy Policy and Conservation Act (EPCA, P.L. 94-163). These authorities also provide for U.S. participation in emergency-sharing activities of the International Energy Agency (IEA) without risking violation of antitrust law and regulation. The 104<sup>th</sup> and 105<sup>th</sup> Congresses agreed to fairly short-term extensions of the authorities governing the use of the SPR, pending a broader review of SPR policy. The 106<sup>th</sup> Congress passed a short-term extension of the SPR (P.L. 106-64) until March 31, 2000, to allow additional time for consideration of legislation (S. 1051, H.R. 2884) to extend the authorities until the end of FY2003. No agreement was reached before the authorities expired on March 31, 2000.

On April 12, 2000, the House passed (416-8) an amended version of H.R. 2884. It included an amendment added by Representative Barton that would provide DOE with the option of buying oil from marginal well operators at \$15 per barrel, adjusted for inflation, if the national average price of crude falls below that level. The bill also included an amendment addressing the complementary high-oil-price concerns of Northeastern states dependent upon home heating oil. That amendment authorized creation of a 2.0 million barrel home heating oil reserve for the Northeastern United States. Opposition to the House

provisions, including the home heating oil reserve and the Barton amendment, led to a hold being placed on the legislation in the Senate, which meant that it would require 60 votes to bring the measure up for debate.

In a bid to raise the number of opportunities for SPR reauthorization to pass, the House Committee on Appropriations on June 20, 2000, by voice vote, added to the FY2001 Energy and Water Appropriations Act a simple extension until September 30, 2001, of the EPCA authorities governing the SPR. On June 27, the House amended and lengthened the extension to the end of FY2003. The House also added other provisions previously passed by the House in H.R. 2884, including provisions for the establishment of a Northeastern home heating oil reserve, and for the purchase of stripper well oil for the SPR in the event of a future sharp and prolonged plunge in oil prices. These provisions were all subsequently dropped from the Energy and Water Appropriations bill. After the hold was lifted on H.R. 2884, the Senate passed an amended version on October 19, 2000, including more extensive language governing drawdown of the regional reserve. The House approved the Senate version on October 24, 2000, and the bill was signed into law (P.L. 106-469) by the President on November 9, 2000, extending the authorities to the end of September 2003. The conferees on comprehensive energy legislation (H.R. 4) in the 107<sup>th</sup> Congress agreed to a permanent extension of the SPR authorities; however, Congress adjourned without passing the legislation.

## The Drawdown Authorities

The Energy Policy and Conservation Act (EPCA) authorizes drawdown of the Reserve upon a finding by the President that there is a “severe energy supply interruption.” This is deemed by the statute to exist if three conditions are joined: If “(a) an emergency situation exists and there is a significant reduction in supply which is of significant scope and duration; (b) a severe increase in the price of petroleum products has resulted from such emergency situation; and (c) such price increase is likely to cause a major adverse impact on the national economy.”

Congress enacted additional drawdown authority in 1990 (Energy Policy and Conservation Act Amendments of 1990, P.L. 101-383) after the *Exxon Valdez* oil spill, which interrupted the shipment of Alaskan oil, triggering spot shortages and price increases. The intention was to provide for an SPR drawdown under a less rigorous finding than that mandated by EPCA. This section, 42 U.S.C. § 6241(h), would allow the President to use the SPR for a short period without having to declare the existence of a “severe energy supply interruption” or the need to meet obligations of the United States under the international energy program.

Under this provision, a drawdown may be initiated in the event of a circumstance that “constitutes, or is likely to become, a domestic or international energy supply shortage of significant scope or duration” and where “action taken ... would assist directly and significantly in preventing or reducing the adverse impact of such shortage.” This authority allows for a limited use of the SPR. No more than 30 million barrels may be sold over a maximum period of 60 days, and this limited authority may not be exercised at all if the level of the SPR is below 500 million barrels. Though this authority has never been formally used, it may have been the model for a swap ordered by President Clinton on September 22, 2000 (see p. 9). As noted above, agreement on extension of the EPCA authorities was not reached

until the final days of the 106<sup>th</sup> Congress (P.L. 106-469). During the roughly 7 months that no formal authorities were in place, the Administration's position was that the existence of an annual appropriation for the SPR conveys Congress' intention to maintain the SPR irrespective of whether or not the statutes have lapsed. The existence of legislative proposals in both the House and Senate to fund the SPR in FY2001 and to reauthorize the program were also interpreted by DOE counsel as further evidence of Congress' intention toward the SPR. If a future Congress agrees to a permanent authorization of the SPR, this sort of issue may be avoided in the future.

## **Purchases of Crude Oil**

With the expiration in the late 1980s of the most recent agreement with Petroleos Mexicanos (PEMEX), the Defense Fuels Supply Center resumed making purchases for the SPR on behalf of DOE from the spot market until fill was suspended for a second time after FY1994. The federal deficit was a major concern, and in light of the common interests established between consuming and producing nations during the Gulf War, the Reserve was deemed by a majority in Congress to be sufficiently filled.

Alternative approaches to direct purchase of oil for the Reserve were studied and debated during the 1980s. Most alternatives had distinct disadvantages or risks. Among the options examined at length were the sale of oil-denominated bonds with the revenues applied to oil purchases; imposition of SPR-dedicated fees on gasoline or oil imports; and sale of the Naval Petroleum Reserves (NPR) or dedication of NPR revenues to SPR purchases. The only option examined thought to have the same advantages as direct purchases was oil leasing.

In the 102nd Congress, omnibus energy legislation in the House (H.R. 776) included a provision that would have required that refiners of domestic and imported oil be assessed 1% of their domestic and imported crude, and imported refined product purchases or cash equivalent, to provide 150,000 b/d for the SPR. The George H. W. Bush Administration and the industry were opposed to this approach, arguing that a set-aside would be the equivalent of a tax and that it would be borne disproportionately by certain companies. The contentious set-aside language was struck on the House floor, and a similar provision in the Senate was defeated during committee markup.

From 1995 until the latter part of 1998, sales of SPR oil, not acquisition, were at the center of debate. However, reduction and elimination of the annual federal budget deficit and the precipitous drop in crude oil prices into early 1999 generated new interest in replenishing the SPR, either to further energy security objectives or as a means of providing price support to domestic producers who were struggling to keep higher-cost, marginal production in service. As an initiative to help domestic producers, Secretary of Energy Bill Richardson requested that the Office of Management and Budget (OMB) include \$100 million in the FY2000 budget request for oil purchases. The proposal was rejected. It was also periodically suggested that it be U.S. policy to purchase domestic oil for the SPR as a means of keeping marginal wells in production. The SPR reauthorization enacted by the 106<sup>th</sup> Congress (P.L. 106-469) included an amendment authorizing purchase of oil from U.S. wells producing 15 barrels or less (25 or less if there is a high water content to the recovered oil) in the event that the price of crude falls to \$15/barrel (bbl) or below.

In September 1998, the Big Hill SPR site in Texas was activated as a foreign trade subzone, which would enable foreign countries to store surplus production in the Reserve without paying customs fees and taxes, but there have been no developments in this regard.

The terrorist attacks upon the United States on September 11, 2001, accelerated interest in purchasing crude for the SPR. Some have thought, in the short term, that depending upon the nature of the U.S. response and potential reprisals, the possibility exists for a politically driven interruption in oil exports bound for U.S. shores, a threat to waterborne tankers, or sabotage of oil facilities in the United States itself.

Some argue that this is a prudent time to fill the SPR. On November 13, 2001, President Bush ordered fill of the SPR to its capacity of 700 million barrels, relying upon oil acquired by the government through royalty-in-kind.

## **Royalty-In-Kind Acquisition for the SPR**

When OMB turned down DOE's request to fund purchases for SPR oil in FY1999, DOE suggested as an alternative that a portion of the royalties to the government from oil leases in the Gulf of Mexico be accepted "in kind" (in the form of oil) rather than as revenues. The Department of Interior (DOI) was reported to be unfavorably disposed to the (RIK) proposal, but a plan to proceed with such an arrangement was announced on February 11, 1999. (Legislation had also been introduced — H.R. 498 — in the 106<sup>th</sup> Congress to direct the Minerals Management Service to accept royalty-in-kind oil.) Producers have favored institution of such a program because they maintain the current system for valuation of oil at the wellhead is complex and flawed. Acquiring oil for the SPR by RIK avoids the necessity for Congress to make outlays to finance direct purchase of oil; however, it also means a loss of revenues in so far as the royalties are paid in wet barrels rather than in cash.

Final details were worked out during the late winter of 1999. The ultimate intention was to replace the 28 million barrels that were sold in recent years; it would take about 10 months to replenish this volume at the anticipated rate of roughly 100,000 b/d. At its inception, the RIK plan was greeted as a well-intended and helpful first step. This Clinton program, and the return of oil that was "swapped out" from the SPR in 2000 by the Clinton Administration, would account for a total of 47 million barrels to be restored to the SPR. President Bush's initiative projects adding another 108 million barrels to bring the SPR to existing capacity in 2005. RIK deliveries under President Bush's order began in April 2002 at the rate of 60,000 b/d, and are scheduled to reach 130,000 b/d. Deliveries of RIK oil are contracted through the end of FY2003, but it is possible that these deliveries could be slowed or postponed depending upon the duration of the general strike in Venezuela, the possibility of a prolonged war with Iraq, and OPEC's response to market conditions.

**Table 1** summarizes the number of sources that provided oil for the Reserve from the program's inception until the end of 1995, when conventional fill was suspended. Following the test sale and actual drawdown of SPR oil during the Persian Gulf War, the SPR's holdings declined to 568.5 million barrels. Purchases restored the reserve to nearly 591.6 million barrels before they were suspended. Replacement of oil "swapped" from the SPR and storage of RIK oil had increased SPR storage to nearly 600 million barrels by the end of 2002.

**Table 1. SPR: Crude Oil Received Through 1995**  
(millions of barrels)

| <b>Source</b>         | <b>Net Contract/Quantity</b> | <b>Percent of Total/%</b> |
|-----------------------|------------------------------|---------------------------|
| Mexico                | 256.7                        | 41.9                      |
| North Sea (U.K.)      | 147.3                        | 24.0                      |
| United States         | 48.1                         | 7.8                       |
| Saudi Arabia          | 27.1                         | 4.4                       |
| Libya                 | 23.7                         | 3.9                       |
| Iran                  | 20.0                         | 3.3                       |
| UAE                   | 18.4                         | 3.0                       |
| Nigeria               | 15.1                         | 2.5                       |
| Norway                | 11.9                         | 1.9                       |
| Oman                  | 9.0                          | 1.5                       |
| Egypt                 | 8.9                          | 1.5                       |
| Ecuador               | 6.2                          | 1.0                       |
| Algeria               | 6.2                          | 1.0                       |
| Cameroon              | 3.4                          | 0.6                       |
| Iraq                  | 3.4                          | 0.6                       |
| Gabon                 | 2.4                          | 0.4                       |
| Qatar                 | 2.3                          | 0.4                       |
| Angola                | 1.0                          | 0.2                       |
| Venezuela             | 0.9                          | 0.1                       |
| Peru                  | 0.4                          | 0.1                       |
| Argentina             | 0.4                          | 0.1                       |
| <b>Total Receipts</b> | <b>612.8</b>                 | <b>100.0</b>              |

**Source:** U.S. Department of Energy

## Drawdown of the Reserve

### Drawdown Capability

The resources of the Strategic Petroleum Reserve are of little value unless DOE can remove, transport, and sell the oil expeditiously and in significant volume during a supply emergency. SPR drawdown and distribution capability was designed to be 4.3 million barrels per day (mbd), sustainable for 90 days. However, owing to the decommissioning of the Weeks Island storage site (completed during FY1999) the drawdown capability for the SPR would be roughly 4.1 million barrels daily during the first 90 days.

Although fears were expressed periodically during the 1980s whether the facilities for withdrawing oil from the Reserve were in proper readiness, the absence of problems during the first real drawdown in early 1991, during the Persian Gulf War, appears to have allayed much of that concern. However, some SPR facilities and infrastructure were beginning to

reach the end of their operational life. A Life Extension Program, initiated in 1993 and now completed, upgraded or replaced all major systems to ensure the SPR's readiness to 2025.

Concern has also been periodically raised about whether the SPR would be able to provide meaningful relief to Hawaii. Reauthorization legislation enacted late in the 105<sup>th</sup> Congress (P.L. 105-388) included new provisions that would allow companies servicing Hawaii to enter into a binding agreement for purchase of SPR oil during a drawdown. The state would be assured some quantity of oil at a price that would be an average of all successful bids. The volume sold to Hawaii in this manner could be subject to certain limits.

## **Debate Over When to Use the Reserve**

A debate during the 1980s over when, and for what purpose, to initiate a drawdown of SPR oil reflected the significant shifts that were taking place in the operation of oil markets after the experiences of the 1970s, and deregulation of oil price and supply. Sales of SPR oil authorized by the 104th Congress — and in committee in the 105th — renewed the debate for a time. The intended use of the SPR has become an issue again, beginning with the rise in home heating prices during the winter of 1999-2000.

The SPR Drawdown Plan, submitted by the Reagan Administration in late 1982, provided for price-competitive sale of SPR oil. The plan rejected the idea of conditioning a decision to distribute SPR oil on any “trigger” or formula. To do so, the Administration argued, would discourage private sector initiatives for preparedness or investment in contingency inventories. Many analysts, in and out of Congress, agreed with the Administration that reliance upon the marketplace during the shortages of 1973 and 1979 would probably have been less disruptive than the price and allocation regulations that were imposed. But many argued that the SPR should be used to moderate the price effects that can be triggered by even small shortages (like those of the 1970s or the tight inventories experienced during the spring of 1996) and lack of confidence in supply availability. Early drawdown of the SPR, some argued, was essential to achieve these desirable objectives.

The Reagan Administration revised its position in January 1984, announcing that the SPR would be drawn upon early in a disruption. This new policy was hailed as a significant departure, easing considerably congressional discontent over the Administration's preparedness policy, but it also had international implications. Some analysts began to stress the importance of coordinating stock drawdowns worldwide during an emergency lest stocks drawn down by one nation merely transfer into the stocks of another, and defeat the price-stabilizing objectives of a stock drawdown. In July 1984, responding to pressure from the United States, the International Energy Agency agreed “in principle” to an early drawdown, reserving decisions on “timing, magnitude, rate and duration of an appropriate stockdraw” until a specific situation needed to be addressed.

This debate was revisited in the aftermath of the Iraqi invasion of Kuwait on August 2, 1990. The escalation of gasoline prices and the prospect that there might be a worldwide crude shortfall approaching 4.5-5.0 million barrels daily prompted some to call for drawdown of the SPR. The debate focused on whether SPR oil should be used to moderate anticipated price increases, before oil supply problems had become physically evident.

In the days immediately following the Iraqi invasion of Kuwait, the George H. W. Bush Administration indicated that it would not draw down the SPR in the absence of a physical shortage simply to lower prices. On the other hand, some argued that a perceived shortage does as much and more immediate damage than a real one, and that flooding the market with stockpiled oil to calm markets is a desirable end in itself. From this perspective, the best opportunity to use the SPR during the first months of the crisis was squandered. It became clear during the fall of 1990 that, in a decontrolled market, physical shortages are less likely to occur. Instead, shortages are likely to be expressed in the form of higher prices as purchasers are free to bid as high as they wish to secure scarce supply.

Within hours of the first air strike against Iraq in January 1991, the White House announced that President Bush was authorizing a drawdown of the SPR, and the IEA activated the plan on January 17. Crude prices plummeted by nearly \$10/barrel (bbl) in the next day's trading, falling below \$20/bbl for the first time since the original invasion. The price drop was attributed to optimistic reports about the allied forces' crippling of Iraqi air power and the diminished likelihood, despite the outbreak of war, of further jeopardy to world oil supply. The IEA plan and the SPR drawdown did not appear to be needed to help settle markets, and there was some criticism of it. Nonetheless, more than 30 million barrels of SPR oil was put out to bid, and 17.3 million barrels were sold and delivered in early 1991.

The Persian Gulf War was an important learning experience about ways in which the SPR might be deployed to maximize its usefulness in decontrolled markets. As previously noted, legislation enacted by the 101st Congress, P.L. 101-383, liberalized drawdown authority for the SPR to allow for its use to prevent minor or regional shortages from escalating into larger ones; an example was the shortages on the West Coast and price jump that followed the Alaskan oil spill of March 1989. In the 102nd Congress, omnibus energy legislation (H.R. 776, P.L. 102-486) broadened the drawdown authority further to include instances where a reduction in supply appeared sufficiently severe to bring about an increase in the price of petroleum "severe" enough to "likely . . . cause a major adverse impact on the national economy."

A new dimension of SPR drawdown and sale was introduced by the Clinton Administration's proposal in its FY1996 budget to sell 7 million barrels to help finance the SPR program. While agreeing that a sale of slightly more than 1% of SPR oil was not about to cripple U.S. emergency preparedness, some in the Congress vigorously opposed the idea, in part because it might establish a precedent that would bring about additional sales of SPR oil for purely budgetary reasons, as did indeed occur. There were three sales of SPR oil during FY1996. The first was to pay for the decommissioning of the Weeks Island site. The second was for the purpose of reducing the federal budget deficit, and the third was to offset FY1997 appropriations. The total quantity of SPR sold was 28.1 million barrels, and the revenues raised were \$544.7 million.

## **Calls for a Drawdown: Home Heating Oil, Winter 1999-2000**

At the start of 2000, reducing the federal budget deficit was no longer the argument for a sale of SPR oil. Some now argued that the leap in home heating oil prices from the winter of 1998-1999 to the winter of 1999-2000 was a rationale for drawing down the SPR. As the price increases generalized to diesel fuel, heating oil, and gasoline, the calls for an SPR drawdown began to multiply.

Oil prices began making a sharp recovery in the late winter of 1999, rising from the low teens at the beginning of the year to more than \$22/bbl by the early fall and crossing \$30/bbl in mid-February 2000. A major cause was production cuts settled upon in March 1999 by the Organization of Petroleum Exporting Countries (OPEC) and other major oil-exporting nations. On September 21, 1999, warning of high home heating oil prices in the winter in the Northeast, Senator Schumer made the first of several requests to then-Secretary of Energy Richardson to authorize a drawdown from the SPR to blunt price increases.

At issue during the winter of 1999-2000 was whether the price for home heating oil had reached a level severe enough to stir a shift in policy governing SPR use – and whether the SPR could be any sort of remedy. Though the price of heating oil and other petroleum products is inextricably tied to oil supply, policy governing SPR use has generally been that SPR oil is to be used primarily to ameliorate oil supply shortages and their consequences (including higher prices), but not to be used to explicitly regulate prices.

Additionally, some argued that a drawdown of the SPR would not alleviate the problem. The Clinton Administration's contention was that high prices were the consequence of a number of temporary factors that could not be resolved any faster by intervention. This was because the tight supply of home heating oil in the Northeast was due in part to idle refinery capacity and refiners' drawdown of stocks during recent months while crude prices were escalating. Refiners preferred to use lower-cost inventory rather than purchase higher-priced crude. Prolonged freezing temperatures also had made certain ports less accessible, adding to distribution problems. The Administration argued that the high prices prevailing would encourage increased production of home heating oil, a shift of refined product stocks to the Northeast, and additional product imports that would arrive in due course. Though it would take some weeks for these effects to take hold, the argument was that these developments would alleviate the supply problem long before a drawdown from the SPR could help. In the meantime, some governors requested and received additional funds from LIHEAP, the Low-Income Home Energy Assistance Program administered by the Department of Health and Human Services.

As gasoline and diesel fuel prices began to increase in the late winter of 2000, the calls for an SPR drawdown began to come from sections of the country other than the Northeast. The Administration continued to oppose a drawdown, investing its efforts instead in a number of trips by then-Secretary Richardson to the Middle East and elsewhere to talk with OPEC oil ministers, and the oil ministers of other oil-exporting nations. Following OPEC's commitment on March 28, 2000, to boost production, crude price began to decline to the mid-twenties. The pressure for an SPR drawdown had subsided by the first week of April 2000; however, it resumed in June 2000 when gasoline prices began to reach and breach \$2.00/gallon in the Midwest.

## **September 2000: A Swap Is Announced**

As the summer of 2000 ended, crude oil prices continued to escalate despite boosts in production by the OPEC cartel. Stocks of home heating oil had been at historic lows, and concern was growing about the fresh pressure that escalating crude prices, colder weather, and anticipated refinery maintenance might have on home heating price and supply during the winter. On September 22, 2000, President Clinton announced a swap of 30 million barrels of oil from the SPR, and contracts were awarded on October 4. Interested parties bid

to borrow quantities of not less than 1 million barrels. Contracts were awarded on the basis of how much oil bidders offered to return to the SPR between August 1 and November 30, 2001. In effect, bidders based their offers on their best models of what it would cost them to acquire replacement crude, weighed against the benefit to them of having additional supply at the beginning of the winter. Although there were reports that interest in the swap was thin, this proved not to be the case. DOE awarded 24 million barrels of sweet crude, and 6 million barrels of sour. Under the contracts accepted by DOE, a total of 31.5 million barrels were to be returned to the SPR in 2001.

Over the course of the days between announcement of the swap, and to the day after the awards were made, crude prices softened from \$37 to less than \$31/bbl. It was arguable how much of this was attributable to the swap, or whether, absent the escalation in Middle East tensions during the week of October 9, 2000, the decrease would have been maintained anyway. It may have been that U.S. willingness to use the SPR temporarily took the wind out of a speculative element in the futures market. Some argued that the Administration announcement was a calculated political gesture to affect price, that the circumstances did not merit a drawdown of SPR oil, and that adding crude to the market would do little to boost home heating oil supply because refineries were operating at near capacity. Others contended that there was a legitimate need to call upon SPR supply, that it would increase supply and exert some stabilizing influence.

The preponderant risk in the transaction has been borne by the oil companies or refiners who placed bids. The volume a refiner promised to return, and the price at the time the refiner acquired the replacement crude, determines the refiner's effective return on participating in the swap. However, in the absence of congressional appropriations to acquire oil for the SPR in recent years, the Reserve receives under the swap a net acquisition that it would not have otherwise had. In that sense, it is not especially material whether or not the quantity of oil returned to the SPR is at price parity with the quantity originally borrowed.

Criticism of the swap was renewed when three bidders awarded a total of 10 million barrels of sweet crude were having difficulties securing letters of credit. Two were unable to meet the deadline; on October 14, 2000, DOE awarded the 7 million barrels they controlled to three firms who had been successful bidders in the initial solicitation.

The peculiar circumstances surrounding some of the original bidders spurred fresh criticism and congressional hearings into the swap, as did reports that higher prices for home heating oil in Europe were likely to draw product refined from the SPR crude to overseas market. Senator Murkowski, Chairman of the Senate Energy Committee, issued a press release on October 6, 2000, underscoring the irony that oil from the U.S. SPR might relieve European, rather than domestic markets. While it can be argued that, in a world market, it does not greatly matter where the product goes, a principal issue here appeared to be the reluctance among some European nations to draw upon their own strategic stocks. Officials in Spain and France called for a coordinated stock drawdown by the European Union in light of the U.S. action, but opinion was divided among the membership, and it was supposed that countries more receptive to such a drawdown would be disinclined to act independently. An advantage of a European drawdown is that these stocks are held in the form of refined products, as well as crude, and would reach product markets faster. European Union distillate stocks were reported to cover 100 days' demand. On October 16, 2000, Secretary

of Energy Richardson indicated that several domestic refiners had agreed to temporarily cease exporting home heating oil.

On March 29, 2001, the repayment schedule was renegotiated to allow five companies to return nearly 24 million barrels of the swapped oil between December 2001-January 2003. To compensate for the extension of the schedule, DOE will receive additional oil, bringing the total projected repayment to 33.54 million barrels. It is believed that the schedule was renegotiated to keep pressure off crude markets, and to keep this volume of oil in the private sector where it could be tallied in industry stocks going into the winter of 2001-2002. Delivery of the last 5.9 million barrels yet to be replaced was renegotiated in December 2002 as the fall in crude exports from Venezuela contributed to a tightness in world oil markets.

## **Establishment of a Regional Home Heating Oil Reserve**

While a number of factors contributed to the virtual doubling in some Northeastern locales of home heating oil prices during the winter of 1999-2000, one that drew the particular attention of lawmakers was the sharply lower level of middle distillate stocks immediately beforehand. It renewed interest in establishment of a regional reserve of home heating oil. The Energy Policy and Conservation Act (EPCA, P.L. 94-163) includes authority for the Secretary of Energy to establish regional reserves as part of the broader Strategic Petroleum Reserve; however, the actual SPR Plan originally presented to Congress in 1977 did not provide specifically for a regional reserve. In the 106<sup>th</sup> Congress, legislation was introduced in both the House and Senate (S. 2047, H.R. 3608) to establish a regional reserve.

On April 12, 2000, the House included in SPR reauthorization legislation (H.R. 2884) language to establish a 2.0 million barrel home heating oil reserve in the Northeast. Within 45 days of enactment, the Secretary would transmit to Congress a plan detailing how the Reserve would be developed. The legislation extends latitude to the Secretary of Energy to acquire storage capacity and refined product by purchase, contract, exchange or lease. Home heating oil from the Reserve could be released in the event of a severe supply disruption, a "severe" price increase, or "another emergency affecting the Northeast." The same language was also included by the House in its version of the FY2001 Energy and Water Appropriations bill (H.R. 4733).

President Clinton endorsed establishment of a regional reserve in his radio address on April 18, 2000, but requested that Congress specifically authorize such a reserve for the Northeast. When the House and Senate had not resolved their differences over SPR reauthorization, the Administration announced on July 10, 2000, its intention to proceed with establishment of a regional home heating oil reserve on an interim basis after DOE's General Counsel made the determination that congressional enactment of FY2001 appropriations for the SPR was sufficient authority to proceed. The Administration also submitted to Congress an amendment to the Strategic Petroleum Reserve Plan that would give the regional reserve permanent status. The proposed amendment provided for a regional distillate reserve, not to exceed two million barrels. On July 18, 2000, the Senate amended H.R. 4578, the FY2001 Interior Appropriations, to provide \$4 million for funding the regional reserve. The conferees provided \$8 million, including a transfer of \$4 million in unexpended funds from the SPR Petroleum Acquisition account. The House approved the conference report on

October 4, 2000 (348-69), and the President signed it into law (P.L. 106-291) on October 11, 2000.

DOE invited bids for the provision of storage and distillate. Crude oil from the SPR was to be provided in exchange for the product and facilities. On August 20, 2000, DOE announced that the regional reserve would be situated at three sites: (1) Equiva Trading would provide 500,000 barrels of storage at a terminal in New Haven, Connecticut; (2) Morgan Stanley Capital Group, Inc., would provide an additional 500,000 barrels of storage at its own site in New Haven; and (3) 1 million barrels would be stored in a Woodbridge, New Jersey, terminal (considered part of the New York Harbor) operated by Amerada Hess. The terminals in New Haven can distribute product by tanker, barge, tank truck or connection to the Buckeye Pipeline. The New Jersey site, near Perth Amboy, distributes heating oil by barge.

On August 24, 2000, DOE accepted a bid from Equiva to provide 1 million barrels of distillate to the two sites in New Haven, and on August 29, announced that the remaining 1 million barrels of home heating oil would be provided to the Amerada Hess storage terminal by Morgan Stanley Capital Group, Inc. The regional reserve was filled by the middle of October 2000.

Controversy over the regional reserve, and the language that would govern its use had been caught up in differences between the House and Senate over extension of the EPCA authorities in 2000. Opponents of establishing a regional reserve suspected that it might be tapped at times that some consider inappropriate, and that the potential availability of the reserve could be a disincentive for the private sector to maintain inventories as aggressively as it would if there were no reserve. One critic of the proposal, the Petroleum Industry Research Foundation, predicted that “aggressive use of a government reserve to hold down prices would hold down the supply response as well.” However, advocates of the regional reserve pointed out that the experience of the 1999-2000 winter demonstrated how the problems experienced in the Northeast can quickly generalize into associated increases in the price of other petroleum fuels. They argued that the benefits from measures that prevent the sort of price increases experienced in home heating oil ultimately are shared by consumers of diesel fuel and gasoline, too.

An approach that was proposed by Senator Murkowski in the 106<sup>th</sup> Congress and included in the Senate version of H.R. 2884 was passed by unanimous consent on October 19, 2000. It predicated drawdown on a regional supply shortage of “significant scope and duration,” or if – for seven consecutive days – the price differential between crude oil and home heating oil increased by more than 60% over its five-year rolling average. The intention was to make the threshold for use of the regional reserve high enough so that it would not discourage oil marketers and distributors from stockbuilding. The House approved the Senate version of H.R. 2884 on October 24, 2000, and it was signed into law (P.L. 106-469) by the President on November 9, 2000. The regional reserve was officially titled the Northeast Heating Oil Reserve (NHOR).

During mid- and late December 2000, the 60% differential was breached. However, this was due to a sharp decline in crude prices rather than to a rise in home heating oil prices. In fact, home heating oil prices were drifting slightly lower during the same reporting period. As a consequence, while the 60% differential was satisfied, other conditions prerequisite to

authorizing a drawdown of the NHOR were not. Nonetheless, some Democratic members of Congress were urging President Clinton to initiate a drawdown from the NHOR before leaving office. By February 2001, heating oil stocks had recovered sufficiently to ease any serious concerns about adequacy of supply during the remainder of that winter. Barring the possibility of military conflict in the Middle East and severe cold weather, supplies of home heating oil are deemed to be adequate for the winter of 2002-2003.

DOE updates and posts a table weekly which shows the various inputs that go into the calculation to determine the current differential. The threshold for use of the home heating oil reserve was not breached during the winter of 2001-2002. (For additional information on the establishment of the NHOR, readers are also referred to CRS Report RL30781, *U.S. Home Heating Oil Price and Supply During the Winter of 2000-2001: Policy Options.*)

## The FY2003 Budget

The FY2003 budget request for the SPR is for \$188.8 million, representing an increase of \$9.8 million from the appropriation for FY2002. The total request includes \$169.8 million for operations and management of the SPR sites. An additional \$11.0 million is being sought to support the costs of transporting RIK oil to SPR sites. In the Senate, the Committee on Appropriations recommended a total of \$189.9 million, including \$158.9 for facilities development and operations, \$16.0 million for management, \$7.0 million for transporting RIK oil to the SPR, and \$8 million for the Northeast Home Heating Oil Reserve. The Committee reduced the SPR Petroleum Account by \$4.0 million, transferring that money to development and operations for the express purpose of helping to pay for injection of oil into the Reserve. The House Appropriations Committee approved \$190.9 million, essentially following the Senate model with an additional \$1 million for management. The 107th Congress adjourned without final action on the Interior appropriations. The program is currently funded at FY2002 levels under a continuing resolution.

## CHRONOLOGY

- 09/24/02** — Conferees on comprehensive energy legislation (H.R. 4) agreed to language that would permanently authorize the SPR and require fill to its current capacity of approximately 700 million barrels. The 107th Congress would adjourn without enacting this legislation.
- 11/13/01** -- President George W. Bush ordered that the SPR be filled to its capacity of 700 million barrels with oil paid to the government as royalty-in-kind.
- 03/29/01** -- DOE agreed to a renegotiated schedule for return of nearly 24 million barrels of the oil “swapped” from the SPR. Five companies are to return oil between December 2001-January 2003, and will provide an additional 2.2 million barrels to compensate for the delay.

- 11/09/00** -- President Clinton signed legislation (P.L. 106-469, H.R. 2884) reauthorizing the SPR and permanently establishing a Northeast Heating Oil Reserve (NHOR).
- 09/22/00** -- President Clinton authorized a “swap” of 30 million barrels from the SPR.
- 07/10/00** -- The Clinton Administration initiated establishment of an interim regional home heating oil reserve, and transmitted to the Congress an amendment to the SPR Plan that would make the regional reserve permanent.
- 08/11/99** -- DOE announced that the Weeks Island site had been filled with brine, was stable geologically, and ready to be turned over to the General Services Administration for disposition. Of the oil stored in Weeks Island, 98% was recovered and transferred to other SPR sites.
- 06/16/99** -- DOE announced four contracts to provide an additional 9.3 million barrels to the SPR as royalty-in-kind for production from federal leases. This brought the total volume settled upon to date from this program to more than 13 million barrels.
- 02/11/99** -- Secretary of Energy Bill Richardson announced a plan that would provide 28 million barrels of oil to the SPR at the rate of 100,000 b/d of crude oil as payment “in-kind” of royalties on federal leases in the Gulf of Mexico.
- 05/11/98** -- President Clinton canceled the FY1998 sale of oil from the SPR.
- 11/13/96** -- DOE announced that it had accepted another \$53.5 million in bids for SPR oil authorized to be sold during FY1997, raising total sales for that fiscal year to \$142 million, or roughly two-thirds of the amount authorized by P.L. 104-208.
- 04/29/96** -- President Clinton ordered the release of 12 million barrels of SPR oil to help blunt a recent runup in crude and product prices.
- 03/00/96** -- DOE completed sale of SPR oil authorized to finance emptying and decommissioning of the Weeks Island site. Owing to higher crude prices, sale of 5.1 million barrels, at an average price of \$18.92/bbl, was sufficient to generate \$96.4 million in revenues.
- 09/30/94** -- The FY1995 Department of Interior and Related Agencies Appropriations Act (P.L. 103-332) essentially curtailed oil purchases and fill of the SPR for FY1995, in keeping with the Clinton Administration’s budget proposal.
- 10/24/92** -- P.L. 102-486 enacted, broadening the circumstances under which the SPR could be tapped, providing for expansion of the SPR to one billion barrels, and including further provisions affecting leasing, potential purchases of oil stripper well production, and requiring a study of how U.S. insular areas would be accommodated in the event of a disruption.

- 06/19/92** — The SPR took delivery of the first oil since fill was suspended in 1990.
- 05/12/92** — The George H. W. Bush Administration announced purchase of one million barrels of North Sea oil for the SPR at a contract price of \$19.78, plus transportation costs. A few days earlier, arrangements were announced for delivery of 2.4 million barrels of Naval Petroleum Reserve oil over a 4-month period commencing in June 1992.
- 02/25/91** — The George H. W. Bush Administration announced it was preparing to resume purchase of oil for the SPR on international spot markets at a rate of 25,000 b/d for three months.
- 01/16/91** — Within hours of the initial air attacks on Iraq, President George H. W. Bush authorized a drawdown of the Strategic Petroleum Reserve in support of a plan agreed to just days earlier by the International Energy Agency.
- 08/08/90** — The George H. W. Bush Administration indicated its willingness to use the SPR in the event of “any severe supply interruption,” but indicated that any release of SPR crude would be coordinated with U.S. allies.
- 08/01/90** — Iraqi forces invaded Kuwait and met minimal resistance. Acquisition of oil for the SPR was suspended.
- 07/11/84** — The IEA agreed in principle that government-owned or -controlled oil stocks should be used early during a supply disruption if deemed helpful to calming nervous oil markets and restraining price increases. The agreement did not supersede the emergency sharing program already in place, but was intended to broaden the repertoire of emergency responses that the IEA may consider.
- 01/24/84** — Secretary of Energy Donald Hodel testified before the Senate Subcommittee on Energy, Nuclear Proliferation, and Government Processes of the Committee on Governmental Affairs that the Reagan Administration supported early use of the Strategic Petroleum Reserve during a petroleum disruption to help stabilize markets.
- 05/00/82** — DOE released a report required by the Omnibus Budget Reconciliation Act of 1981, which concluded that a Reserve larger than 750 million barrels would not provide net economic benefits to the United States.
- 06/30/80** — Congress passed the Energy Security Act requiring that the SPR be filled at a rate of at least 100,000 b/d for FY1981 beginning October 1, 1980. Fill was resumed in late September 1980.
- 03/00/79** — Purchase of oil for the SPR was suspended because of the tight international crude oil market, Saudi objections, and budget considerations.
- 08/00/77** — First crude oil pumped into SPR.

**12/22/75** — Energy Policy Conservation Act (P.L. 94-163) authorized the Strategic Petroleum Reserve.

## FOR ADDITIONAL READING

U.S. Congress. Senate. Committee on Energy and Natural Resources. Subcommittee on Energy Research, Development, Production and Regulation. *Energy Policy and Conservation Act*. Hearing on S. 1051. Sept. 14, 1999. S.Hrg. 106-329.