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December 12, 2019

VIA CM/ECF

Ms. Patricia S. Connor
Clerk of the Court
U.S. Court of Appeals for the Fourth Circuit
1100 East Main Street, Suite 501
Richmond, Virginia 23219

Re: *Mayor and City Council of Baltimore v. BP p.l.c., et al.*; Case No. 19-1644

Dear Ms. Connor:

Appellants submit this letter in response to the Court's question at argument regarding whether the government ever exercised its right to extract petroleum from the Elk Hills Reserve (the "Reserve"). The Naval Petroleum Reserves Production Act of 1976 ("Production Act"), Pub. L. No. 94-258, April 5, 1976, 90 Stat. 303, cited at JA.214, directs the Secretary of the Navy ("Secretary"), within 90 days, "to produce such reserves at the maximum efficient rate consistent with sound engineering practices for a period not to exceed six years[.]" *See* Ex.A. at 4 (Sec. 201(3)(c)(1)(B)). The Production Act gave the Secretary authority to "sell or otherwise dispose of the United States share of such petroleum produced from such reserves[.]" *Id.* at 5 (Sec. 201(3)(c)(1)(C)). These provisions demonstrate that Congress authorized production at the Reserve. As set forth in the Unit Plan Contract ("UPC"), the government had final authority over all production, which was carried out by Standard Oil, and later Chevron (Standard's successor). JA.241-259

Appellants also submit a report produced by the General Accounting Office ("GAO") regarding Oil Sales Procedures and Prices at Elk Hills, April through December 1986. Ex.B (cited at JA.214). Although Chevron conducted the exploration and drilling activities on the Reserve, "Chevron and the government share[d] production, revenues, and expenses in proportion to their ownership shares." *Id.* at 3; *see also United States v. Standard Oil Co.*, 545 F.2d 624, 636-37 (9th Cir. 1976) (noting dispute over Navy's payment of its share of costs). From 1976 to 1998, the Reserve generated over \$17 billion for the United States Treasury. *See* Department of Energy, Naval Petroleum Reserves, <https://www.energy.gov/fe/services/petroleum-reserves/naval-petroleum-reserves>.

The Court may take judicial notice of the Production Act, GAO report, and DOE website as "matters of public record" that "can be accurately and readily determined from sources

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whose accuracy cannot reasonably be questioned.” *Goldfarb v. Mayor and City Council of Baltimore*, 791 F.3d 500, 508 (4th Cir. 2015) (quoting Fed. R. Evid. 201(b)); *see also United States v. Gavegnano*, 305 F. App’x 954 (4th Cir. 2009) (“the authority of courts to take judicial notice” of “statutes” is “unquestionable” (citation omitted)).

Sincerely,

Theodore J. Boutrous Jr.
GIBSON, DUNN & CRUTCHER LLP

*Counsel for Defendants-Appellants
Chevron Corporation and Chevron U.S.A.*

cc: All counsel of record (via ECF)

Exhibit A

PL 94-258, April 5, 1976, 90 Stat 303

UNITED STATES PUBLIC LAWS

94th Congress - Second Session

Convening January 19, 1976

DATA SUPPLIED BY THE U.S. DEPARTMENT OF JUSTICE. (SEE SCOPE)

Additions and Deletions are not identified in this document.

PL 94-258 (HR 49)

April 5, 1976

An Act to authorize the Secretary of the Interior to establish on certain public lands of the United States national petroleum reserves the development of which needs to be regulated in a manner consistent with the total energy needs of the Nation, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,
That this Act may be cited as the "Naval Petroleum Reserves Production Act of 1976" 42 USC 6501 note.

TITLE I—NATIONAL PETROLEUM RESERVE IN ALASKA DEFINITION

Sec. 101. 42 USC 6501. As used in this title, the term "petroleum" includes crude oil, gases (including natural gas), natural gasoline, and other related hydrocarbons, oil shale, and the products of any of such resources.

DESIGNATION OF THE NATIONAL PETROLEUM RESERVE IN ALASKA

Sec. 102. 42 USC 6502. The area known as Naval Petroleum Reserve Numbered 4, Alaska, established by Executive order of the President, dated February 27, 1923, 43 CFR app. except for tract Numbered 1 as described in Public Land Order 2344, dated April 24, 1961, shall be transferred to and administered by the Secretary of the Interior in accordance with the provisions of this Act. Effective on the date of transfer all lands within such area shall be redesignated as the "National Petroleum Reserve in Alaska" (hereinafter in this title referred to as the "reserve"). Subject to valid existing rights, all lands within the exterior boundaries of such reserve are hereby reserved and withdrawn from all forms of entry and disposition under the public land laws, including the mining and mineral leasing laws, and all other Acts; but the Secretary is authorized to (1) make dispositions of mineral materials pursuant to the Act of July 31, 1947 (61 Stat. 681), as amended (30 U.S.C. 601), for appropriate use by Alaska Natives, (2) make such dispositions of mineral materials and grant such rights-of-way, licenses, and permits as may be necessary to carry out his responsibilities under this Act, and (3) convey the surface of lands properly selected on or before December 18, 1975, by Native village corporations pursuant to the Alaska Native Claims Settlement Act, 43 USC 1601 note. All other provisions of law heretofore enacted and actions heretofore taken reserving such lands as to Naval Petroleum Reserve shall remain in full force and effect to the extent not inconsistent with this Act. TRANSFER OF JURISDICTION

Sec. 103. 42 USC 6503. Jurisdiction over the reserve shall be transferred by the Secretary of the Navy to the Secretary of the Interior on June 1, 1977.

(b) With respect to any activities related to the protection of environmental, fish and wildlife, and historical or scenic values, the Secretary of the Interior shall assume all responsibilities as of the date of the enactment of this title. As soon as possible, but not later than the effective date of transfer, the Secretary of the Interior may promulgate such rules and regulations as he deems necessary and appropriate for the protection of such values within the reserve.

(c) The Secretary of the Interior shall, upon the effective date of the transfer of the reserve, assume the responsibilities and functions of the Secretary of the Navy under any contracts which may be in effect with respect to activities within the reserve.

(d) On the date of transfer of jurisdiction of the reserve, all equipment, facilities, and other property of the Department of the Navy used in connection with the operation of the reserve, including all records, maps, exhibits, and other information data held by the Secretary of the Navy in connection with the reserve, shall be transferred without reimbursement from the Secretary of the Navy to the Secretary of the Interior who shall thereafter be authorized to use them to carry out the provisions of this title.

(e) On the date of transfer of jurisdiction of the reserve, the Secretary of the Navy shall transfer to the Secretary of the Interior all unexpended funds previously appropriated for use in connection with the reserve and all civilian personnel ceilings assigned by the Secretary of the Navy to the management and operation of the reserve as of January 1, 1976.

ADMINISTRATION OF THE RESERVE

Sec. 104. 42 USC 6504. (a) Except as provided in subsection (e) of this section, production of petroleum from the reserve is prohibited and no development leading to production of petroleum from the reserve shall be undertaken until authorized by an Act of Congress.

(b) Any exploration within the Utukok River, the Teshekpuk Lake areas, and other areas designated by the Secretary of the Interior containing any significant subsistence, recreational, fish and wildlife, or historical or scenic value, shall be conducted in a manner which will assure the maximum protection of such surface values to the extent consistent with the requirements of this Act for the exploration of the reserve.

(c) The Secretary of the Navy shall continue the ongoing petroleum exploration program within the reserve until the date of the transfer of jurisdiction specified in section 103(a). Prior to the date of such transfer of jurisdiction the Secretary of the Navy shall—

(1) cooperate fully with the Secretary of the Interior providing him access to such facilities and such information as he may request to facilitate the transfer of jurisdiction;

(2) provide to the Committees on Interior and Insular Affairs of the Senate and the House of Representatives copies of any reports, plans, or contracts pertaining to the reserve that are required to be submitted to the Committees on Armed Services

of the Senate and the House Representative; and

(3) cooperate and consult with the Secretary of the Interior before executing any new contract or amendment to any existing contract pertaining to the reserve and allow him a reasonable opportunity to comment on such contract or amendment, as the case may be.

(d) The Secretary of the Interior shall commence further petroleum exploration of the reserve as of the date of transfer of jurisdiction specified in section 103 (a). In conducting this exploration effort, the Secretary of the Interior—

(1) is authorized to enter into contracts for the exploration of the reserve, except that no such contract may be entered into until at least thirty days after the Secretary of the Interior has provided the Attorney General with a copy of the proposed contract and such other information as may be appropriate to determine legal sufficiency and possible violations under, or inconsistencies with, the antitrust laws. If, within such thirty day period, the Attorney General advises the Secretary of the Interior that any such contract would unduly restrict competition or be inconsistent with the antitrust laws, then the Secretary of the Interior may not execute that contract;

(2) shall submit to the Committees on Interior and Insular Affairs of the Senate and the House of Representatives any new plans or substantial amendments to ongoing plans for the exploration of the reserve. All such plans or amendments submitted to such committees pursuant to this section shall contain a report by the Attorney General of the United States with respect to the anticipated effects of such plans or amendments on competition. Such plans or amendments shall not be implemented until sixty days after they have been submitted to such committees; and

(3) shall report annually to the Committees on Interior and Insular Affairs of the Senate and the House of Representatives on the progress of, and future plans for, exploration of the reserve.

(e) Until the reserve is transferred to the jurisdiction of the Secretary of the Interior, the Secretary of the Navy is authorized to develop and continue operation of the South Barrow gas field, or such other fields as may be necessary, to supply gas at reasonable and equitable rates to the native village of Barrow, and other communities and installations at or near Point Barrow, Alaska, and to installations of the Department of Defense and other agencies of the United States located at or near Point Barrow, Alaska. After such transfer, the Secretary of the Interior shall take such actions as may be necessary to continue such service to such village, communities, installations, and agencies at reasonable and equitable rates.

STUDY OF THE RESERVE

Sec. 105. (a) Section 164 of the Energy Policy and Conservation 42 USC 6244. is hereby amended by deleting in the first sentence “to the Congress” and by inserting in lieu thereof “to the Committees on Interior and Insular Affairs of the Senate and House of Representatives”.

(b) (1). 42 USC 6505. The President shall direct such Executive departments and/ or agencies as he may deem appropriate to conduct a study, in consultation with representatives of the State of Alaska, to determine the best overall procedures to be used in the development, production, transportation, and distribution of petroleum resources in the reserve. Such study shall include, but shall not be limited to, a consideration of—

(A) the alternative procedures for accomplishing the development, production, transportation, and distribution of the petroleum resources from the reserve, and

(B) the economic and environmental consequences of such alternative procedures.

(2) The President shall make semiannual progress reports on the implementation of this subsection to the Committees on Interior and Insular Affairs of the Senate and the House of Representatives beginning not later than six months after the date of the enactment of this Act and shall, not later than one year after the transfer of jurisdiction of the reserve, and annually thereafter, report any findings or conclusions developed as a result of such study together with appropriate supporting data and such recommendations as he deems desirable. The study shall be completed and submitted to such committees, together with recommended procedures and any proposed legislation necessary to implement such procedures not later than January 1, 1980.

(c) (1) 42 USC 6505. The Secretary of the Interior shall establish a task force to conduct a study to determine the values of, and best uses for, the lands contained in the reserve, taking into consideration (A) the natives who live or depend upon such lands, (B) the scenic, historical, recreational, fish and wildlife, and wilderness values, (C) mineral potential, and (D) other values of such lands.

(2) Such task force shall be composed of representatives from the government of Alaska, the Arctic slope native community, and such offices and bureaus of the Department of the Interior as the Secretary of the Interior deems appropriate, including, but not limited to, the Bureau of Land Management, the United States Fish and Wildlife Service, the United States Geological Survey, and the Bureau of Mines.

(3) The Secretary of the Interior shall submit a report, together with the concurring or dissenting views, if any, of any non-Federal representatives of the task force, of the results of such study to the Committees on Interior and Insular Affairs of the Senate and the House of Representatives within three years after the date of enactment of this title and shall include in such report his recommendations with respect to the value, best use, and appropriate designation of the lands referred to in paragraph (1). ANTITRUST PROVISIONS

Sec. 106. 42 USC 6506. Unless otherwise provided by Act of Congress, whenever development leading to production of petroleum is authorized, the provisions of subsections (g), (h), and (i) of section 7430 of title 10, United States Code, shall be deemed applicable to the Secretary of the Interior with respect to rules and regulations, plans of development and amendments thereto, and contracts and operating agreements. All plans and proposals submitted to the Congress under this title or pursuant to legislation authorizing development leading to production shall contain a report by the Attorney General of the United States on the anticipated effects upon competition of such plans and proposals.

AUTHORIZATION FOR APPROPRIATIONS

Sec. 107. 42 USC 6507. (a) There are authorized to be appropriated to the Department of the Interior such sums as may be necessary to carry out the provisions of this title.

(b) If the Secretary of the Interior determines that there is an immediate and substantial increase in the need for municipal services and facilities in communities located on or near the reserve as a direct result of the exploration and study activities authorized by this title and that an unfair and excessive financial burden will be incurred by such communities as a result of the increased need for such services and facilities, then he is authorized to assist such communities in meeting the costs of providing increased municipal services and facilities. The Secretary of the Interior shall carry out the provisions of this section through existing Federal programs and he shall consult with the heads of the departments or agencies of the Federal Government concerned with the type of services and facilities for which financial assistance is being made available.

TITLE II— NAVAL PETROLEUM RESERVES

Sec. 201. Chapter 641 of title 10, United States Code, is amended as follows:

(1) Immediately before section 7421 insert the following new section: “Sec. 7420. 10 USC 7420. Definitions

“(a) In this chapter—

“(1) ‘national defense’ includes the needs of, and the

planning and preparedness to meet, essential defense, industrial, and military emergency energy requirements relative to the national safety, welfare, and economy, particularly resulting from foreign

military or economic actions;

“(2) ‘naval petroleum reserves’ means the naval petroleum and oil shale reserves established by this chapter, including Naval Petroleum Reserve Numbered 1 (Elk Hills), located in Kern County, California, established by Executive order of the President, dated September 2, 1912; Naval Petroleum Reserve Numbered 2 (Buena Vista), located in Kern County, California, established by Executive order of the President, dated December 13, 1912; Naval Petroleum Reserve Numbered 3 (Teapot Dome), located in Wyoming, established by Executive order of the President, dated April 30, 1915; Naval Petroleum Reserve Numbered 4, Alaska, established by Executive order of the President, dated February 27, 1923 (until redesignated as the National Petroleum Reserve in Alaska under the jurisdiction of the Secretary of the Interior as provided in the Naval Petroleum Reserves Production Act of 1976); Oil Shale Reserve Numbered 1, located in Colorado, established by Executive order of the President, dated December 6, 1916, as amended by Executive order dated June 12, 1919; Oil Shale Reserve Numbered 2, located in Utah, established by Executive order of the President, dated December 6, 1916; and Oil Shale Reserve Numbered 3, located in Colorado, established by Executive order of the President, dated September 27, 1924;

“(3) ‘petroleum’ includes crude oil, gases (including natural gas), natural gasoline, and other related hydrocarbons, oil shale, and the products of any of such resources;

“(4) ‘ Secretary’ means the Secretary of the Navy;

“(5) ‘small refiner’ means an owner of a refinery or refineries (including refineries not in operation) who qualifies as a small business refiner under the rules and regulations of the Small Business Administration; and

“(6) ‘maximum efficient rate’ means the maximum sustainable daily oil or gas rate from a reservoir which will permit economic development and depletion of that reservoir without detriment to the ultimate recovery.”.

(2) 10 USC 7421. Section 7421 (a) is amended—

(A) by striking out “of the Navy”;

(B) by striking out “and oil shale”;

(C) by striking out “for naval purposes” and inserting in lieu thereof “for national defense purposes”; and

(D) by striking out “section 7438 hereof” and inserting in lieu thereof “this chapter”.

(3) 10 USC 7422. The text of section 7422 is amended to read as follows:

“(a) The Secretary, directly or by contract, lease, or otherwise, shall explore, prospect, conserve, develop, use, and operate the naval petroleum reserves in his discretion, subject to the provisions of subsection (c) and the other provisions of this chapter; except that no petroleum leases shall be granted at Naval Petroleum Reserves Numbered 1 and 3.

“(b) Except as otherwise provided in this chapter, particularly subsection (c) of this section, the naval petroleum reserves shall be used and operated for—

“(1) the protection, conservation, maintenance, and testing of those reserves; or

“(2) the production of petroleum whenever and to the extent that the Secretary, with the approval of the President, finds that such production is needed for national defense purposes and the production is authorized by a joint resolution of Congress.

“(c) (1) In administering Naval Petroleum Reserves Numbered 1, 2, and 3, the Secretary is authorized and directed—

“(A) to further explore, develop, and operate such reserves;

“(B) commencing within ninety days after the date of enactment of the Naval Petroleum Reserves Production Act of 1976, to produce such reserves at the maximum efficient rate consistent with sound engineering practices for a period not to exceed six years after the date of enactment of such Act;

“(C) during such production period or any extension thereof to sell or otherwise dispose of the United States share of such petroleum produced from such reserves as hereinafter provided; and

“(D) to construct, acquire, or contract for the use of storage and shipping facilities on and off the reserves and pipelines and associated facilities on and off the reserves for transporting petroleum from such reserves to the points where the production from such reserves will be refined or shipped.

Any pipeline in the vicinity of a naval petroleum reserve not otherwise operated as a common carrier may be acquired by the Secretary by condemnation, if necessary, if the owner thereof refuses to accept, convey, and transport without discrimination and at reasonable rates any petroleum produced at such reserve. With the approval of the Secretary, rights-of-way for new pipelines and associated facilities may be acquired by the exercise of the right of eminent domain in the appropriate United States district court. Such rights-of-way may be acquired in the manner set forth in the Act of February 26, 1931, chapter 307 (46 Stat. 1421; 40 U.S.C. 258 (a)), and the prospective holder of the right-of-way is ‘the authority empowered by law to acquire the lands’ within the meaning of that Act. Such new pipelines shall accept, convey, and transport without discrimination and at reasonable rates any petroleum produced at such reserves as a common carrier. Pipelines and associated facilities constructed at or produced for Naval Petroleum Reserve Numbered 1 pursuant to this subsection shall have adequate capacity to accommodate not less than three hundred fifty thousand barrels of oil per day and shall be fully operable as soon as possible, but not later than three years after the date of enactment of the Naval Petroleum Reserves Production Act of 1976.

“(2) At the conclusion of the six-year production period authorized by paragraph (1) (B) of this subsection the President may extend the period of production in the case of any naval petroleum reserve for additional periods of not to exceed three years each—,

“(A) after the President requires an investigation to be made, in the case of each extension, to determine the necessity for continued production from such naval petroleum reserve;

“(B) after the President submits to the Congress, at least one hundred eighty days prior to the expiration of the current production period prescribed by this section, or any extension thereof, a copy of the report made to him on such investigation together with a certification by him that continued production from such naval petroleum reserve is in the national interest; and

“(C) if neither House of Congress within ninety days after receipt of such report and certification adopts a resolution disapproving

further production from such naval petroleum reserve.

“(3) The production authorization set forth in paragraph (1) (B) of this subsection, in the case of Naval Petroleum Reserve Numbered 1, is conditioned upon the private owner of any lands or interests therein within such reserve agreeing with the Secretary to continue operations of such reserve under a unitized plan contract which adequately protects the public interest; however, if such agreement is not reached within ninety days after the date of enactment of the Naval Petroleum Reserves Production Act of 1976 the Secretary is authorized to exercise the authority for condemnation conferred by section 7425 of this chapter.”.

(4) 10 USC 7423. The first sentence of section 7423 is amended by deleting “of the Navy” and “or products”.

(5) 10 USC 7424. Section 7424 is amended—,

(A) by deleting “of the Navy” in the text of subsection (a) preceding clause (1);

(B) by deleting “and oil shale” in subsection (a) (1) in the text preceding subclause (A); and

(C) by deleting “in the ground” in clause (1) (A) of subsection (a).

(6) 10 USC 7425. Section 7425 is amended by deleting “of the Navy”.

(7) 10 USC 7426. Section 7426(a) is amended by striking out “the Secretary of the Navy” and inserting in lieu thereof “Subject to the provisions of section 7422(c), the Secretary”.

(8) 10 USC 7427. The first and second sentences of section 7427 are amended by striking out “of the Navy”.

(9) 10 USC 7428. Section 7428 is amended by striking out “within the naval petroleum and oil shale reserves shall contain a provision authorizing the Secretary of the Navy” and inserting in lieu thereof “within Naval Petroleum Reserve Numbered 2 and the oil shale reserves shall contain a provision authorizing the Secretary”.

(10) 10 USC 7429. The first sentence of section 7429 is amended by deleting “of the Navy”.

(11) 10 USC 7430. The text of section 7430 is amended to read as follows:

“(a) In administering the naval petroleum reserves under this chapter, the Secretary shall use, store, or sell the petroleum produced from the naval petroleum reserves and lands covered by joint, unit, or other cooperative plans.

“(b) Notwithstanding any other provision of law, each sale of the United States share of petroleum shall be made by the Secretary at public sale to the highest qualified bidder, for periods of not more than one year, at such time, in such amounts, and after such advertising as the Secretary considers proper and without regard to Federal, State, or local regulations controlling sales or allocation of petroleum products.

“(c) In no event shall the Secretary permit the award of any contract which would result in any person obtaining control, directly or indirectly, over more than 20 per centum of the estimated annual United States share of petroleum produced from Naval Petroleum Reserve Numbered 1.

“(d) Each proposal for sale under this title shall provide that the terms of every sale of the United States share of petroleum from the naval petroleum reserves shall be so structured as to give full and equal opportunity for the acquisition of petroleum by all interested persons, including major and independent oil producers and refiners alike. When the Secretary, in consultation with the Secretary of the Interior, determines that the public interests will be served by the sale of petroleum to small refiners not having their own adequate sources of supply of petroleum, the Secretary is authorized and directed to set aside a portion of the United States share of petroleum produced for sale to such refiners under the provisions of this section for processing or use in such refineries, except that—

“(1) none of the production sold to small refiners may be resold in kind;

“(2) production must be sold at a cost of not less than the prevailing local market price of comparable petroleum;

“(3) the set-aside portion may not exceed 25 per centum of the estimated annual United States share of the total production from all producing naval petroleum reserves; and

“(4) notwithstanding the provisions of subsection (b) of this section, the Secretary may, at his discretion if he deems it to be in the public interest, prorate such petroleum among such refiners

for sale, without competition, at not less than the prevailing local market price of comparable petroleum.

“(e) Any petroleum produced from the naval petroleum reserves, except such petroleum which is either exchanged in similar quantities for convenience or increased efficiency of transportation with persons or the government of an adjacent foreign state, or which is temporarily exported for convenience or increased efficiency of transportation across parts of an adjacent foreign state and reenters the United States, shall be subject to all of the limitations and licensing requirements of the Export Administration Act of 1969 (83 Stat. 841) 50 USC app. 2401 note. and, in addition, before any petroleum subject to this section may be exported under the limitations and licensing requirement and penalty and enforcement provisions of the Export Administration Act of 1969, the President must make and publish an express finding that such exports will not diminish the total quality or quantity of petroleum available to the United States and that such exports are in the national interest and are in accord with the Export Administration Act of 1969.

“(4) (f) During the period of production or any extension thereof authorized by section 7422(c), the consultation and approval requirements of section 7431 (a) (3) are waived.

“(g) (1) Prior to the promulgation of any rules and regulations, plans of development and amendments thereto, and in the entering and making of contracts and operating agreements relating to the development, production, or sale of petroleum in or from the reserves, the Secretary shall consult with and give due consideration to the views of the Attorney General of the United States with respect to matters which may affect competition.

“(2) No contract or operating agreement may be made, issued, or executed under this chapter until at least thirty days after the Secretary notifies the Attorney General of the proposed contract or operating agreement. Such notification shall contain such information as the Attorney General may require in order to advise the Secretary as to whether such contract or operating agreement may create or maintain a situation inconsistent with the antitrust laws. If, within such thirty day period, the Attorney General advises the Secretary that a contract or operating agreement may create or maintain a situation inconsistent with the antitrust laws, then the Secretary may not make, issue, or execute that contract or operating agreement.

“(h) Nothing in this chapter shall be deemed to confer on any person immunity from civil or criminal liability, or to create defenses to actions, under the antitrust laws.

“(i) As used in this section, the term ‘antitrust laws’ means—

“(1) the Act entitled ‘ An Act to protect trade and commerce against unlawful restraints and monopolies’, approved July 2, 1890 (15 U.S.C. 1 et seq.), as amended;

“(2) the Act entitled ‘ An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes’, approved October 15, 1914 (15 U.S.C. 12 et seq.), as amended;

“(3) the Federal Trade Commission Act (15 U.S.C. 41 et seq.), as amended;

“(4) sections 73 and 74 of the Act entitled ‘ An Act to reduce taxation, to provide revenue for the Government, and for other purposes’, approved August 27, 1894 (15 U.S.C. 8 and 9), as amended; or

“(5) section 2, 3, and 4 of the Act of June 19, 1936, chapter 592 (15 U.S.C. 13a, 13b, and 21a).

“(j) Any pipeline which accepts, conveys, or transports any petroleum produced from Naval Petroleum Reserves Numbered 1 or Numbered 3 shall accept, convey, and transport without discrimination and at reasonable rates any such petroleum as a common carrier insofar as petroleum from such reserves is concerned. Every contract entered into by the Secretary for the sale of any petroleum owned by the United States which is produced from such reserves shall contain provisions implementing the requirements of the preceding sentence if the contractor owns a controlling interest in any pipeline or any company operating any pipeline, or is the operator of any pipeline, which carries any petroleum produced from such naval petroleum reserves. The Secretary may promulgate rules and regulations for the purpose of carrying out the provisions of this section and he, or the Secretary of the Interior where the authority extends to him, may declare forfeit any contract, operating agreement, right-of-way, permit, or easement held by any person violating any such rule or regulation. This section shall not apply to any natural gas common carrier pipeline operated by any person subject to regulation under the Natural Gas Act 15 USC 717w. or any public utility subject to regulation by a State or municipal regulatory agency having jurisdiction to regulate the rates and charges for the sale of natural gas to consumers within the State or municipality.

“(k) The President may, at his discretion, direct that all or any part of the United States share of petroleum produced from the naval petroleum reserves be placed in strategic storage facilities as authorized by sections 151 through 166 of the Energy Policy and Conservation Act 42 USC 6231—6246. or that all or any part of such share be exchanged for petroleum of equal value for the purpose of placing such petroleum in such strategic storage facilities.”.

(12) 10 USC 7431. Section 7431 is amended—

(A) by inserting “(a)” immediately before “ The Committees”;

(B) by striking out “or oil shale” in clauses (1) and (2);

(C) by striking out “and oil shale” in clauses (2) and (3);

(D) by striking out “oil and gas (other than royalty oil and gas), oil shale, and products therefrom” in clause (3) and inserting in lieu thereof “petroleum (other than royalty oil and gas)”;

(E) by adding at the end thereof the following new subsections:

“(b) (1) During the period of production authorized by section 7422(c), the Secretary shall submit to the Committees on Armed Services of the Senate and the House of Representatives any new plans or substantial amendments to ongoing plans for the exploration, development, and production of the naval petroleum reserves.

“(2) All plans or substantial amendments submitted to the Congress pursuant to this section shall contain a report by the Attorney General of the United States with respect to the anticipated effects of such plans or amendments on competition. Such plans or amendments shall not be implemented until sixty days after such plans or amendments have been submitted to such committees.

“(c) During the period of production authorized by section 7422 (c), the Secretary shall submit annual reports as of the first day of the fiscal year to the Committees on Armed Services of the Senate and the House of Representatives, and such committees shall cause such reports to be printed as a Senate or House document, as appropriate. The Secretary shall include in such reports, with respect to each naval petroleum reserve, an explanation in detail of the following:

“(1) the status of the exploration, development, and production programs;

“(2) the production that has been achieved, including the disposition of such production and the proceeds realized therefrom;

“(3) the status of pipeline construction and procurement and problems related to the availability of transportation facilities;

“(4) a summary of future plans for exploration, development, production, disposal, and transportation of the production from the naval petroleum reserves; and

“(5) such other information regarding the reserve as the Secretary deems appropriate.”.

(13) 10 USC 7432. Section 7432 is amended to read as follows: ” Sec. 7432. Naval petroleum reserves special account

“(a) There is hereby established on the books of the Treasury Department a special account designated as the ‘naval petroleum reserves special account’. There shall be credited to such account—

- “(1) all proceeds realized under this chapter from the disposition of the United States share of petroleum;
- “(2) the net proceeds, if any, realized from sales or exchanges within the Department of Defense of refined petroleum products accruing to the benefit of any component of that department as the result of any such sales or exchanges;
- “(3) such additional sums as may be appropriated for the maintenance, operation, exploration, development, and production of the naval petroleum reserves;
- “(4) such royalties as may accrue under the provisions of section 7433;

10 USC 7433. and

- “(5) any other revenues resulting from the operation of the naval petroleum reserves.
- “(b) Funds available in the naval petroleum reserve special account shall be available for expenditure in such sums as are specified in annual appropriations Acts for the expenses of—
 - “(1) exploration, prospecting, conservation, development, use, operation, and production of the naval petroleum reserves as authorized by this chapter;
 - “(2) production (including preparation for production) as authorized by this chapter, or as may hereafter be authorized;
 - “(3) the construction and operation of facilities both within and outside the naval petroleum reserves incident to the production and the delivery of petroleum, including pipelines and shipping terminals;
 - “(4) the procurement of petroleum for, and the construction and operation of facilities associated with, the Strategic Petroleum Reserve authorized by sections 151 through 166 of the Energy Policy and Conservation Act;

42 USC 6231—6246. and

“(5) the exploration and study of the National Petroleum Reserve in Alaska as authorized in title I of the Naval Petroleum Reserves Production Act of 1976.

“(c) The budget estimates for annual appropriations from the naval petroleum reserves special account shall be prepared by the Secretary and shall be presented to the Congress by the President independently of the budget of the Department of the Navy and the Department of Defense.

“(d) Contracts under this chapter providing for the obligation of funds may be entered into by the Secretary for a period of five years renewable, at the option of the Secretary, for an additional five-year renewable, at the option of the Secretary for an additional five-year period; however, such contracts may obligate funds only to the extent that such funds are made available in annual appropriations.”.

(14) 10 USC 7433. Section 7433(a) is amended by striking out “of the Navy”.

(b) Section 7433 (b) is amended by striking out “and oil shale”.

(16) 10 USC 7434. Section 7434 is amended by striking out “and oil shale”.

(17) 10 USC 7435. Section 7435 (b) is amended by striking out “of the Navy”.

(18) 10 USC 7436. Section 7435 (a) is amended by deleting “of the Navy, subject to approval of the President.”.

(19) 10 USC 7438. Section 7438 is amended by striking out “Secretary of the Interior” wherever it occurs and inserting therefor “Administrator of the Energy Research and Development Administration”; and by striking out “of the Navy” wherever it occurs.

(20) The table of sections at the beginning of such chapter is amended—, (A) by inserting immediately before

“7421. Jurisdiction and control.”

the following: “7420. Definitions.” (B) by striking out:

“7432. Expenditures; appropriations chargeable.”

and inserting in lieu thereof the following: “7432. Naval petroleum reserve special account.”

Approved April 5, 1976.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 94—81 Pts. I, 2, 3, (Comm. on Interior and Insular Affairs) and No. 94—156 accompanying H.R. 5919 (Comm. on Armed Services) and No. 94—942 (Comm. of Conference).

SENATE REPORTS: No. 94—327 accompanying S. 2173 (Comm. on Armed Services) and No. 94—708 (Comm. of Conference).

CONGRESSIONAL RECORD:

Vol. 121 (1975): July 8, considered and passed House.

July 28, S. 2173 considered in Senate.

July 29, considered and passed Senate, amended, in lieu of S. 2173.

Vol. 122 (1976): Mar. 24, Senate agreed to conference report.

Mar. 31, House agreed to conference report.

WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS:

Vol. 12, No. 15 (1976): Apr. 5, Presidential statement.

PL 94-258, 1976 HR 49

End of Document

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Exhibit B

United States General Accounting Office 132121

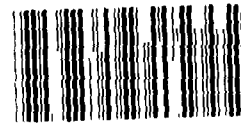
GAO

Fact Sheet for the Chairman,
Subcommittee on Fossil and Synthetic
Fuels, Committee on Energy and
Commerce, House of Representatives

January 1987

NAVAL PETROLEUM RESERVES

Oil Sales Procedures and Prices at Elk Hills, April Through December 1986



132121

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GAO/RCED-87-75FS



United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-208196

January 29, 1987

The Honorable Philip R. Sharp
Chairman, Subcommittee on Fossil
and Synthetic Fuels
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

At your office's request, we updated the information in our earlier fact sheet, Naval Petroleum Reserves: Sales Procedures and Prices Received for Elk Hills Oil (GAO/RCED-86-163FS, May 9, 1986). Specifically, this fact sheet provides information on oil sales procedures and prices received by the Department of Energy (DOE) for oil sold from the Elk Hills Naval Petroleum Reserve (NPR-1) for the period April through December 1986. The procedures in effect for oil sold between April 1 and September 30, 1986, resulted in oil being sold for as low as \$3.91 per barrel.

In light of the information on oil sales prices provided in our previous report, you urged DOE, in a May 12, 1986, letter, to review its sales procedures. On May 15, 1986, you also proposed legislation, ultimately enacted on August 29, 1986 (Public Law 99-413), that limited DOE's authority to sell NPR-1 oil unless certain sales price criteria were met. DOE subsequently revised its procedures in time for the October to December 31, 1986, oil sales period. As a result, DOE received average prices of \$13.42, \$13.70, and \$13.58 per barrel for NPR-1 oil delivered in October, November, and December 1986, respectively, which compared favorably with California oil market prices.

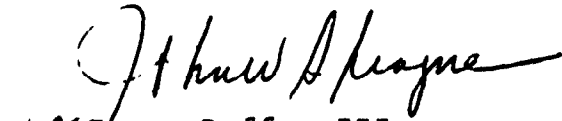
We obtained information on NPR-1 oil sales prices and procedures from DOE documents and discussions with officials at DOE headquarters in Washington, D.C., and the NPR-1 office near Bakersfield, California. We provided DOE program officials with a draft of this fact sheet and discussed its factual accuracy with them. Their comments have been incorporated where appropriate. In accordance with your request, we did not obtain official agency comments.

B-208196

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this fact sheet until 3 days after the date of this letter. At that time, we will provide copies to the Secretary of Energy and other interested parties and will make copies available to others upon request.

If you have any further questions, please contact me on (202) 275-7756. Major contributors to this fact sheet are listed in appendix I.

Sincerely yours,



James Duffus III
Associate Director

BACKGROUND

The Elk Hills Naval Petroleum Reserve (NPR-1), located near Bakersfield, California, ranks seventh among domestic producing oil fields. NPR-1 also produces large quantities of natural gas and natural gas liquids. The U.S. government owns approximately 78 percent of NPR-1, and Chevron, U.S.A., Inc., owns approximately 22 percent. The Department of Energy (DOE) operates the field, but Chevron and the government share production, revenues, and expenses in proportion to their ownership shares.

Between fiscal years 1985 and 1986, DOE reported a decline in revenues generated from the sale of the government's share of crude oil, natural gas, and natural gas liquids as a result of lower petroleum prices and production. In fiscal year 1985, the average daily production rate was over 130,600 barrels of oil; in fiscal year 1986, the rate was about 112,400. Revenues from sales in fiscal year 1985 totaled \$1.3 billion and production costs were about \$111 million. In fiscal year 1986, revenues from sales totaled about \$763 million, while production costs were about \$131 million.

Basis for selling NPR-1 oil

NPR-1 was originally established in 1912 to provide a source of liquid fuels for the armed forces during national emergencies. Crude oil production from the field started in 1919 and continued at various levels, reaching a peak of 65,000 barrels per day in 1945. After World War II, NPR-1 production was slowed to the minimum level necessary to prevent damage to the field. Following the Arab oil embargo in 1973-74, the Naval Petroleum Reserves Production Act of 1976 (Public Law 94-258, April 5, 1976) was enacted. This act authorized and directed that NPR-1 be produced at the maximum efficient rate for 6 years.¹ The act further specified that after 6 years the president could extend production in intervals of up to 3 years after certifying that continued production is in the national interest.

In accordance with the act, the president informed the Congress on October 5, 1984, of his certification that it is in the national interest to continue production of NPR-1 at the maximum efficient rate through a second 3-year period ending on April 5, 1988. The act provides that such petroleum shall be used, stored, or sold. When sold, the government's share of petroleum shall be sold at public sale to the highest qualified bidder without regard to federal, state, or local regulations controlling sales of petroleum products.

¹The maximum sustainable daily rate that permits economic development and depletion of the reservoir without detriment to ultimate recovery.

NPR-1 crude oil was sold in accordance with DOE procedures in effect for sales made through September 30, 1986. New procedures were developed for sales made after October 1, 1986.

Procedures for selling NPR-1 oil under contracts running through September 30, 1986

The government's share of NPR-1 crude oil production is sold on the open market by competitive bidding as provided for by the Naval Petroleum Reserves Production Act. Under procedures for sales through September 30, 1986, DOE solicited bids from interested parties through an invitation for bid and awarded contracts to the highest responsible bidders until all available oil was sold. On the basis of their perceptions of supply and demand conditions in the oil market during the contract period, prospective buyers submitted bids showing the quantity of oil they would purchase and a per barrel bonus or discount that DOE would apply to an established base price in effect on the date of delivery.

To establish the base price, DOE periodically obtained "Crude Oil Price Schedules" from the major oil companies operating in the central California area. These schedules reflected the "posted" prices the oil companies were willing to pay for oil of a specific type and quality. DOE then computed an average price on the basis of the three highest postings for oil of like quality to oil produced from NPR-1 and nearby fields. This average price, with appropriate adjustments for NPR-1 oil quality, became DOE's crude oil base price for the period covered by the price schedules. DOE's base price, and consequently, the prices paid by the purchasers, fluctuated as the relevant posted prices changed during the contract period.

RESULTS OF NPR-1 OIL SALES FROM APRIL 1, 1986 TO SEPTEMBER 30, 1986

On February 28, 1986, DOE awarded contracts to 16 companies for the sale of about 82,000 barrels per day of NPR-1 crude oil between April 1 and September 30, 1986.² These companies bid a record high average discount of \$4.49 from DOE's base price. The discounts ranged from \$0.87 to \$6.98 per barrel. These contracts resulted in DOE selling Elk Hills oil as low as \$3.91 per barrel. The range of prices DOE received for NPR-1 oil is shown in table 1.

²One company later defaulted, and the number was reduced to 15.

Table 1
Prices Received for NPR-1 Oil

<u>Month</u>	<u>Range of prices received</u>	
	<u>High</u>	<u>Low</u>
April	\$11.27	\$6.25
May	10.68	6.23
June	10.60	5.98
July	10.43	4.59
August	9.69	3.91
September	10.47	5.57

Source: DOE Revenue Accounting Office, NPR-1.

The NPR-1 oil prices were largely influenced by the situation that existed in the California oil market. Oil prices in the spot market, for example, began to decline in late November 1985, but the posted prices in California lagged behind this decline until early February 1986. From October 1985 through the first week in February 1986, posted prices had remained fairly stable, ranging from \$24.88 to \$24.95 per barrel. Bids for the April 1 to September 30, 1986, contract period submitted to DOE in late January 1986 were made on the basis of January posted prices with the discounts offered reflecting the disparity between posted prices and spot market prices.

DOE and industry officials stated that the unprecedented discounts were offered in an attempt to minimize or eliminate the differential between the postings and spot prices and reflected the buyers' perceptions of the uncertainties in future oil prices. However, the subsequent decline in posted prices resulted in DOE's base price for NPR-1 oil dropping from \$23.51 on February 10, 1986, to \$14.47 on April 3, 1986. Since then, DOE's base price has gone as low as \$10.41; at the end of September, it had gone back up to \$13.05.

RESULTS OF BONUS/DISCOUNT
BIDDING PROCEDURE

DOE's bonus/discount bidding procedure to sell NPR-1 oil resulted in net bonuses to the government of about \$272 million. Between July 1, 1976, and September 30, 1986, DOE received about \$349 million in bonuses over the prices posted in the NPR-1 area during 10 of DOE's oil sale contract periods. For four contract periods, DOE sold oil at discounts from the posted prices that amounted to about \$77 million. The 6-month contract period ending September 30, 1986, accounted for about \$57 million of the \$77 million in discounts.

CHANGES TO PROCEDURES FOR SELLING
NPR-1 OIL AFTER OCTOBER 1, 1986

On May 12, 1986, the Chairman, Subcommittee on Fossil and Synthetic Fuels, House Committee on Energy and Commerce, sent our May 1986 report to the Secretary of Energy, urging him to assess how DOE's bidding procedures for selling NPR-1 oil could be changed in light of the rapidly changing oil market.³ In addition, on May 15, 1986, the Chairman, along with nine other members, introduced legislation that prohibited the sale of NPR petroleum at a price less than the higher of 90 percent of the current sales price of comparable petroleum in the same area or the price of petroleum being purchased for the Strategic Petroleum Reserve (SPR) minus the cost of transportation from NPR-1 to the SPR.⁴

On May 22, 1986, the Secretary of Energy stated that the process for selling oil from NPR-1 had gotten out of step with today's marketplace and, as a result, the taxpayer was not receiving a fair return on the sale of the crude oil. He ordered a comprehensive review of the bidding process for selling oil to be undertaken immediately.

DOE subsequently revised its sales procedures and on July 29, 1986, requested bids from potential purchasers for the October 1 to December 31, 1986, contract period. The new procedures require bidders to submit a specific price for the oil rather than a bonus or discount to a base price. The highest bidders will then pay that price adjusted monthly on the basis of changes in spot market quotes for two crudes sold on

³Naval Petroleum Reserves: Sales Procedures and Prices Received for Elk Hills Oil (GAO/RCED-86-163FS, May 9, 1986).

⁴Legislation containing these provisions was enacted on August 29, 1986 (Public Law 99-413).

the California spot market.⁵ The new procedures also reduce the contract period from 6 months to 3 months; shorten the time period between the invitation for bids, contract award, and oil delivery; and strengthen the government's right to reject bids deemed unfavorable to the taxpayer. DOE plans to continually monitor and evaluate its experience under the new procedures and make changes as necessary.

Under its new procedures, DOE awarded contracts to 7 companies on September 10, 1986, for the sale of 53,000 barrels of oil per day for the October 1 to December 31, 1986, contract period. Before awarding these contracts, DOE conducted an analysis that concluded that the bids submitted by the proposed awardees complied with the minimum price criteria set forth in Public Law 99-413. Since the act does not prescribe a precise methodology or formula for ensuring compliance, DOE had flexibility in choosing, among other things, current sales prices, comparable petroleum, and the time period to use. The monthly adjustments to the bid prices, based on changes in spot market quotes for the two crudes sold on the California market, resulted in DOE receiving average prices of \$13.42, \$13.70, and \$13.58 per barrel for NPR-1 oil delivered in October, November, and December 1986, respectively. These prices exceeded DOE's averages of the October, November, and December spot market quotes of \$12.84, \$12.72, and \$13.39 respectively, for the two crudes sold on the California market.

OTHER DOE EFFORTS RELATED TO NPR-1 OIL SALES

DOE also initiated other efforts designed to avoid future NPR-1 oil sales at less than fair market value. These include testing the sale and shipment of NPR-1 oil to the SPR and preparing unused storage tanks at NPR-1 for possible storage of oil.

During October 1986, DOE shipped about 267,000 barrels of oil, about 8,600 barrels per day, to the SPR via interstate oil pipelines. According to DOE, the purpose of the shipments was to test the logistics of transporting oil from California to the SPR in Texas and Louisiana. This oil is expected to reach the SPR in February 1987. The NPR office billed the SPR office at prices ranging from \$13.32 to \$13.41 per barrel, based on oil quality, for the NPR oil. These prices were based on DOE's revised procedures for pricing oil sold to its commercial customers. In addition, DOE will pay pipeline tariff charges of \$2.67 per barrel for shipment of the oil to the SPR.

⁵The two crudes are (1) blended oil transported through the Four Corners Pipeline Company's line 63 from the San Joaquin Valley (the area where NPR-1 is located) to the Four Corners' Hynes Station near Los Angeles and (2) Alaska North Slope oil delivered at Los Angeles.

According to DOE, it owns five storage tanks at NPR-1, but they were not in usable condition during most of the last sales contract period. DOE informed us that it put one of these tanks in a usable condition during late summer of 1986 and that this tank, which can hold about 220,000 barrels, has been used to store about 70,000 barrels of NPR-1 oil produced in September 1986.

APPENDIX I

APPENDIX I

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