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DEPARTMENT OF ENERGY

10 CFR Part 626

RIN 1901-AB16

Procedures for the Acquisition of **Petroleum** for the **Strategic Petroleum Reserve**

AGENCY: Office of **Petroleum** Reserves, Department of Energy.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Energy Policy Act of 2005 directs the Secretary of Energy to develop procedures for the acquisition of **petroleum** for the **Strategic Petroleum Reserve** (SPR) in appropriate circumstances. The Department of Energy (DOE) is today proposing procedures for the acquisition of **petroleum** for the SPR, including acquisition by direct purchase and transfer of royalty oil from the Department of the Interior. The proposed rule also has provisions concerning the deferral of scheduled deliveries of **petroleum** for the SPR.

DATES: Comments are due on May 24, 2006.

ADDRESSES: You may submit comments, identified by RIN Number 1901-AB16 by any of the following methods:

Federal eRulemaking Portal: <http://www.regulations.gov>.

Follow the instructions for submitting comments.

E-Mail: nancy.marland@hq.doe.gov. Include RIN Number 1901-AB16 in the subject line of the message.

Mail: Office of **Petroleum** Reserves, FE-40, U.S. Department of Energy, 1000 Independence Avenue, SW., Washington, DC 20585.

You may obtain electronic copies of this notice of proposed rulemaking and review comments received by DOE at the following Web sites: <http://www.fe.doe.gov/programs/reserves> and <http://www.spr.doe.gov>.

Those without Internet access may access this information by visiting the DOE Freedom of Information Reading Room, Rm. 1E-190, 1000 Independence Avenue SW., Washington, DC, (202) 586-3142, between the hours of 9 a.m and 4 p.m., Monday to Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: Lynnette le Mat, Director, Operations and Readiness, Office of **Petroleum** Reserves, FE-43, U.S. Department of

Energy, 1000 Independence Ave., SW., Washington, DC 20585, (202) 586-4398.

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I. Introduction

A. Background

The **Strategic Petroleum** Reserve was established pursuant to the Energy Policy and Conservation Act (EPCA) (42 U.S.C. 6201 et seq.) to store **petroleum** to diminish the impact on the United States of disruptions in **petroleum** supplies and to carry out the obligations of the United States under the International Energy Program. EPCA authorizes the storage of up to one billion barrels of **petroleum** and permits the Secretary of Energy to acquire **petroleum** for storage in the SPR by a variety of methods.

Since its authorization, the Federal Government has created six crude oil storage sites and subsequently decommissioned two of the six. The SPR currently consists of underground storage caverns located in the four Government-owned sites. The locations are Bryan Mound and Big Hill in Texas and West Hackberry and Bayou Choctaw in Louisiana. These four storage locations have salt dome caverns with 727 million barrels of useable storage capacity.

Over the last thirty years, the Government has acquired approximately 800 million barrels of **petroleum** for the SPR. Over 100 million barrels of oil have been withdrawn from the SPR for sale or exchange. The inventory reached its highest level of 700.7 million barrels in August 2005 before the drawdown, exchange and sale of 20.8 million barrels in the aftermath of Hurricane Katrina.

Crude oil was initially acquired for the SPR by direct purchases on the open market. Through an Interagency Agreement, the Department of Defense served as DOE's agent to acquire crude oil using appropriated funds to attempt to meet a series of target fill rates specified by Congress. **Petroleum** was acquired through a combination of spot market purchases and term contracts, including a matching purchase and sale involving the Government's share of production from the Naval **Petroleum**

Reserve in California. Except for various pauses occasioned by geopolitical events, e.g., Desert Storm, the Defense Fuel Supply Center (currently the Defense Energy Support Center) continued to function as DOE's acquisition agent for direct purchases through 1994, at which time funds from direct appropriations and receipts from sales in 1990 and 1991 were exhausted.

In December 1981, DOE entered into the first of a series of four country-to-country contracts with Petroleos Mexicanos (PEMEX), the state-owned oil company of Mexico. These term contracts--under which deliveries of approximately 220 million barrels of **petroleum** were completed in 1990--employed commercial market terms and were priced according to a formula indexed to prices of globally-traded **petroleum**.

In 1996, in a series of congressionally-mandated sales, an aggregate 28 million barrels of SPR inventory were sold to fund SPR programmatic requirements and for general deficit reduction purposes. Subsequently, pursuant to a 1999 Memorandum of Understanding (MOU) between the Department of the Interior (DOI) and DOE, DOE initiated a program to replace the 28 million barrels by the transfer to DOE of crude oil royalties collected in-kind on production from Federal leases in the Gulf of Mexico Outer Continental Shelf. Under this MOU, DOE contracted with commercial entities to receive the royalty oil at offshore production facilities and transfer it to the SPR, either directly or by exchange for other crude oil meeting SPR quality specifications.

In 1998, in order to improve the efficiency of drawdown operations at the Bryan Mound site, DOE conducted a competition under the exchange authority in EPCA to trade crude oil of one type for another type of superior quality. Although this resulted in a net decrease in the number of barrels in inventory, the upgrade in oil quality maintained the value of the

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Government's assets and enhanced emergency response capabilities.

In the fall of 2000, again under the EPCA exchange authority, DOE conducted a time exchange of oil from the SPR. Through open competition, DOE entered into agreements with nine companies to exchange 30 million barrels of oil. Under these agreements, oil delivered to companies from SPR sites was to be repaid the following year with oil of comparable quality and quantity plus additional premium barrels paid as interest.

In November 2001, the Administration announced it would extend the royalty-in-kind program to fill the SPR to a level of 700 million barrels. To accomplish this, a new MOU was signed with the Department of Interior and DOE issued a series of competitive solicitations for six-month terms, similar to those used to acquire the previous 28 million barrels.

At various times since 1999, when the market moved into steep backwardation (prices for future barrels remained consistently low relative to near term prices), suppliers under both the time exchange and royalty-in-kind transfer programs requested that contractually scheduled deliveries to the SPR be delayed. DOE granted these deferral requests through individual negotiations for the future return of the originally scheduled barrels plus additional premium barrels.

In addition, there have been periods when catastrophic events, most recently severe weather, have prompted requests for loans of oil from the SPR. These loans have been conducted as time exchanges in a manner

similar to deferred deliveries, in that the loaned oil is returned plus additional barrels as interest.

B. Energy Policy Act of 2005

The acquisition authority in section 160 of EPCA requires that the Secretary of Energy, to the greatest extent practicable, acquire **petroleum** products for the SPR in a manner consonant with the following objectives:

- Minimization of the cost of the SPR;
- Minimization of the Nation's vulnerability to a severe energy supply interruption;
- Minimization of the impact of such acquisition upon supply levels and market forces; and
- Encouragement of competition in the **petroleum** industry.

(42 U.S.C. 6240).

The recently enacted Energy Policy Act of 2005 (Pub. L. 109-58) generally directs the Secretary of Energy to acquire **petroleum** to fill the SPR to the one billion barrel capacity authorized by section 154(a) of EPCA (42 U.S.C. 6234(a)) as expeditiously as practicable, without incurring excessive cost or appreciably affecting the price of **petroleum** products to consumers. DOE estimates that the acquisition of the approximately 300 million barrel difference between the current and authorized SPR inventory would likely take approximately 15 years. The rate of acquisition depends on the availability of capacity to receive and hold the oil and by the availability of oil either through transfer from the Department of the Interior to DOE or through purchases, which will be affected by the availability of funds.

In addition, section 301(e)(2) of the Energy Policy Act of 2005 amends EPCA by adding a new subsection (c) to section 160. Subsection (c) directs the Secretary of Energy to develop, with public notice and opportunity for comment, procedures consistent with the objectives of section 160 to acquire **petroleum** for the SPR. Such procedures must take into account the need to--

- (1) Maximize overall domestic supply of crude oil (including quantities stored in private sector inventories);
- (2) Avoid incurring excessive cost or appreciably affecting the price of **petroleum** products to consumers;
- (3) Minimize the costs to the Department of the Interior and DOE in acquiring such **petroleum** products (including foregone revenues to the Treasury when **petroleum** products for the SPR are obtained through the royalty-in-kind program);
- (4) Protect national security;
- (5) Avoid adversely affecting current and futures prices, supplies, and inventories of oil; and
- (6) Address other factors that the Secretary determines to be appropriate.

The Energy Policy Act of 2005 further provides that the procedures developed under section 160(c) shall include procedures and criteria for the review of requests for the deferrals of scheduled deliveries.

Along with the direction to expand the SPR to one billion barrels, section 303 of the Energy Policy Act of 2005 requires the Secretary of Energy to complete a proceeding to select sites ``necessary to enable acquisition by the Secretary of the full authorized volume of the **Strategic Petroleum Reserve.**'' (42 U.S.C. 6201 note.) This activity is

currently underway.

Consistent with the principles set forth in EPCA and the objectives of the Energy Policy Act of 2005, DOE now proposes procedures for oil acquisition by direct purchase and by royalty oil transfers from the Department of the Interior. Additionally, the procedures address deferrals of deliveries.

II. Proposed Acquisition Procedures

A. Discussion of Acquisition Principles

DOE will consider a wide range of factors consonant with the objectives set forth in section 160 (b) of EPCA and the new section 160 (c) added by the Energy Policy Act of 2005. Careful and deliberative consideration of these factors will occur prior to acquisition of **petroleum** for the SPR or deferral of scheduled deliveries.

While the mission of the SPR is to provide energy security by storing substantial quantities of **petroleum**, the acquisition of **petroleum** to meet this long term objective must be conducted using the criteria set forth in EPCA, as amended by the Energy Policy Act of 2005. When acquiring **petroleum**, whether by purchase or royalty transfer, DOE will seek to balance the objectives of assuring adequate security and minimizing market stress. To this end, DOE will consider various factors that may be affecting market fundamentals, current and projected SPR and commercial receipt capabilities, and the geopolitical climate. Consistent with the SPR mission, however, energy security will be the overriding objective as long as it does not result in undue impact on markets.

Whether acquiring by purchase or royalty transfer, DOE will seek to maximize the overall domestic supply of crude oil. Assuming the necessary authorizations and appropriations have been made, DOE decisions on crude oil acquisition will take into consideration the current level of the SPR and private inventories, national and regional import dependency, the outlook for international and domestic production levels, oil acquisition by other stockpiling entities, the added security value of the marginal barrel in storage, incipient disruptions of supply or refining capability, the level of market volatility, the demand and supply elasticity to price changes, logistics and economics of **petroleum** movement, and any other considerations that may be pertinent to the balance of **petroleum** supply and demand. More indirect considerations, such as monetary policy, the current and projected rate of economic growth, and impacts on specific domestic market segments, as well as foreign policy considerations may also be pertinent to near-term acquisition strategy. All of these factors are recognized as having an impact, at some level, on U.S. energy security.

The timing of DOE entry into the market, its sustained presence, and the

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quantities sought will all be sensitive to these factors. DOE will remain aware of the extent to which the SPR fill rate and prices paid for its own acquisitions will impact supply availability and prices for other market participants. DOE will strive to avoid incurring excessive cost or appreciably affecting the price of **petroleum** products to consumers by analyzing market activity for crude oil and related

commodities and prices of oil for delivery in future months as well as the perceived availability of near term and forward supplies.

For purchases or exchanges, DOE will ensure the use of commercially reasonable terms and conditions.

B. Vehicles for **Petroleum** Acquisition

DOE may acquire oil for the SPR through direct purchase, the transfer of royalty-in-kind oil, through deferrals and exchanges, or other means authorized in EPCA (42 U.S.C. 6239, 6240). In order to acquire oil, DOE may enter into agreements with other Federal agencies with relevant expertise and resources to acquire oil for the SPR consistent with the provisions of part 626.

1. Direct Purchases

Use of the direct purchase method for oil acquisition is contingent on the availability of funds. If funds are made available, DOE proposes to provide public notice of its intent to issue a solicitation for the acquisition of crude oil. The quantity and quality of oil to be purchased would be identified in the solicitation. When acquiring by direct purchase, DOE would use competitive solicitations to assure that prices paid are fair and reasonable in a global market, and in line with contemporaneous commercial transactions for comparable quality crude oils. The use of open, continuous solicitations that allow entry into price and delivery negotiations would enable DOE to increase the rate of purchases if price volatility reduces prices below trend and offers the opportunity to reduce the average cost of oil acquisition. Under the proposed procedures, DOE also may decrease the rate of purchase if volatility or future price projections indicate a delay would result in better economy and less stress on seasonal markets. DOE's decision to enter the market, delay purchases or defer deliveries would follow the careful analysis of the effect of such a decision on current and futures prices, supplies and inventories of oil.

2. Royalty-in-Kind Transfers

Oil acquisition by royalty-in-kind transfer is conducted in coordination with the Minerals Management Service of the Department of the Interior. The Department of the Interior is responsible for collecting royalties on production from leases on Federally-owned properties. The Federal Government receives royalties of a defined percentage of the amount or value of the oil produced from the leases. Under the royalty-in-kind acquisition method, the royalties are paid ``in kind'', in the oil itself, and transferred to the SPR. In most cases, the royalty oil is provided to private companies under exchange agreements. In turn, these companies are bound by contract to provide oil of suitable quality to the SPR. If the royalty oil is of suitable quality and transportation logistics are amenable, it may be directly transferred to the SPR. DOE expects this would be a small proportion of the total oil transferred.

When using royalty production to fill the SPR, DOE would minimize the cost to the Department of the Interior and DOE through its analysis of royalty values, as well as a comparative analysis of the relative market values of crude oil offered in exchange. Both agencies will encourage the direct transfer of royalty oil to the SPR when in the Government's interest.

3. Deferrals

Secretary of Energy may defer scheduled deliveries to the SPR for the purpose of obtaining additional crude oil. Under the proposed rule, DOE could defer scheduled crude oil deliveries to the SPR to a later

date in exchange for a premium, which would be paid to DOE in oil.

The precise amount of that premium would be negotiated with the contractor by a DOE contracting officer. The determination of an appropriate premium would take into consideration the length of deferral as well as prevailing market conditions.

C. Description of the Proposed Rule

This portion of the supplementary information discusses certain provisions of the proposed rule.

Section 626.03 (Applicability)

This section limits the applicability of these procedures to the acquisition of **petroleum** for the SPR through direct purchase or transfer of royalty-in-kind oil, as well as to deferrals of contractually scheduled deliveries. The procedures do not apply to the following transactions during which oil may be acquired: (1) Country-to-country oil purchases; (2) facility leases with payments in oil; and (3) contracts for oil not owned by the United States as provided for by section 171 of the Energy Policy and Conservation Act. These transactions generally are not conducted primarily for the acquisition of oil by DOE.

Section 626.04 (General Acquisition Strategy)

This proposed section addresses the indicators which will be reviewed by DOE for likely market impacts prior to acquisition of **petroleum** for the SPR.

Section 626.05 (Notice of Acquisition)

This section describes the contents of the acquisition solicitation and issuance activities. The proposed section also discusses the duration of the solicitation, definition of quality specifications, quantity determination, offer procedures and delivery.

Section 626.06 (Acquiring Oil by Direct Purchase)

This proposed section addresses in more detail the development of an acquisition strategy taking into account specific SPR quantitative and qualitative requirements. This proposed section also addresses the method by which solicitations are issued and offers evaluated.

Section 626.07 (Royalty Transfer and Exchange)

This proposed section describes how DOE, in coordination with the Department of the Interior, would proceed to fill the SPR with the Government's share of U.S. Gulf of Mexico offshore royalty production, either by direct transport to SPR facilities or through a competitive exchange with industry. Successful exchange offers generally would be those which provide the greatest value of exchange oil to the Government relative to the value of the royalty oil delivered to the contractor.

Section 626.08 (Deferrals of Contractually Scheduled Deliveries)

This proposed section addresses the conditions in which DOE would consider and the process by which it would delay deliveries scheduled under existing contracts to the mutual benefit of the Government and other market participants.

III. Regulatory Review

A. Executive Order 12866

Today's proposed rule has been determined to be a ``significant regulatory action'' under Executive Order 12866, ``Regulatory Planning and Review,'' 58 FR 51735 (October 4, 1993). Accordingly, this action was subject to review under that Executive Order by the Office of Information and Regulatory

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Affairs of the Office of Management and Budget.

B. National Environmental Policy Act

DOE has determined that this proposed rule is covered under the Categorical Exclusion found in the Department's National Environmental Policy Act regulations at paragraph A.6 of Appendix A to Subpart D, 10 CFR part 1021, which applies to rulemakings that are strictly procedural. Accordingly, neither an environmental assessment nor an environmental impact statement is required.

C. Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) requires preparation of an initial regulatory flexibility analysis for any rule that by law must be proposed for public comment, unless the agency certifies that the rule, if promulgated, will not have a significant economic impact on a substantial number of small entities. As required by Executive Order 13272, ``Proper Consideration of Small Entities in Agency Rulemaking,'' 67 FR 53461 (August 16, 2002), DOE published procedures and policies on February 19, 2003, to ensure that the potential impacts of its rules on small entities are properly considered during the rulemaking process (68 FR 7990). DOE has made its procedures and policies available on the Office of General Counsel's Web site: <http://www.gc.doe.gov>.

DOE has reviewed today's proposed procedures under the provisions of the Regulatory Flexibility Act and the procedures and policies published on February 19, 2003. These proposed procedures would not directly affect small businesses or other small entities. The proposed procedures would apply only to individuals who are engaged in the acquisition of **petroleum** products for the **Strategic Petroleum** Reserve. On the basis of the foregoing, DOE certifies that the proposed procedures, if implemented would not have a significant economic impact on a substantial number of small entities. Accordingly, DOE has not prepared a regulatory flexibility analysis for this rulemaking. DOE's certification and supporting statement of factual basis will be provided to the Chief Counsel for Advocacy of the Small Business Administration pursuant to 5 U.S.C. 605(b).

D. Paperwork Reduction Act

This proposed rule would not impose any new collection of information subject to review and approval by the Office of Management and Budget (OMB) under the Paperwork Reduction Act (PRA), 44 U.S.C. 3501 et seq.

E. Unfunded Mandates Reform Act of 1995

The Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4) generally requires Federal agencies to examine closely the impacts of regulatory actions on State, local, and tribal governments. Subsection 101(5) of title I of that law defines a Federal intergovernmental mandate to include any regulation that would impose upon State, local, or tribal governments an enforceable duty, except a condition of Federal assistance or a duty arising from participating in a voluntary federal program. Title II of that law requires each Federal agency to assess the effects of Federal regulatory actions on State, local, and tribal governments, in the aggregate, or to the private sector, other than to the extent such actions merely incorporate requirements specifically set forth in a statute. Section 202 of that title requires a Federal agency to perform a detailed assessment of the anticipated costs and benefits of any rule that includes a Federal mandate which may result in costs to State, local, or tribal governments, or to the private sector, of \$100 million or more. Section 204 of that title requires each agency that proposes a rule containing a significant Federal intergovernmental mandate to develop an effective process for obtaining meaningful and timely input from elected officers of State, local, and tribal governments.

These proposed procedures would not impose a Federal mandate on State, local or tribal governments. The proposed rule would not result in the expenditure by State, local, and tribal governments in the aggregate, or by the private sector, of \$100 million or more in any one year. Accordingly, no assessment or analysis is required under the Unfunded Mandates Reform Act of 1995.

F. Treasury and General Government Appropriations Act, 1999

Section 654 of the Treasury and General Government Appropriations Act, 1999 (Pub. L. 105-277) requires Federal agencies to issue a Family Policymaking Assessment for any proposed rule that may affect family well being. These proposed procedures apply only to Federal employees involved in the acquisition of **petroleum** products for the SPR. While some of these individuals may be members of a family, the proposed rule would not have any impact on the autonomy or integrity of the family as an institution. Accordingly, DOE has concluded that it is not necessary to prepare a Family Policymaking Assessment.

G. Executive Order 13132

Executive Order 13132 (64 FR 43255, August 4, 1999) imposes certain requirements on agencies formulating and implementing policies or regulations that preempt State law or that have federalism implications. Agencies are required to examine the constitutional and statutory authority supporting any action that would limit the policymaking discretion of the States and carefully assess the necessity for such actions. DOE has examined this proposed rule and has

determined that it would not preempt State law and would not have a substantial direct effect on the States, on the relationship between the National Government and the States, or on the distribution of power and responsibilities among the various levels of government. No further action is required by Executive Order 13132.

H. Executive Order 12988

With respect to the review of existing regulations and the promulgation of new regulations, section 3(a) of Executive Order 12988, Civil Justice Reform, 61 FR 4729 (February 7, 1996), imposes on Executive agencies the general duty to adhere to the following requirements: (1) Eliminate drafting errors and ambiguity; (2) write regulations to minimize litigation; and (3) provide a clear legal standard for affected conduct rather than a general standard and promote simplification and burden reduction. With regard to the review required by section 3(a), section 3(b) of Executive Order 12988 specifically requires that Executive agencies make every reasonable effort to ensure that the regulation: (1) Clearly specifies the preemptive effect, if any; (2) clearly specifies any effect on existing Federal law or regulation; (3) provides a clear legal standard for affected conduct while promoting simplification and burden reduction; (4) specifies the retroactive effect, if any; (5) adequately defines key terms; and (6) addresses other important issues affecting clarity and general draftsmanship under any guidelines issued by the Attorney General. Section 3(c) of Executive Order 12988 requires Executive agencies to review regulations in light of applicable standards in section 3(a) and section 3(b) to determine whether they are met or it is unreasonable to meet one or more of them. DOE has completed the required review and determined that, to the extent permitted by law, the proposed

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procedures meet the relevant standards of Executive Order 12988.

I. Treasury and General Government Appropriations Act, 2001

The Treasury and General Government Appropriations Act, 2001 (44 U.S.C. 3516, note) provides for agencies to review most disseminations of information to the public under guidelines established by each agency pursuant to general guidelines issued by OMB.

OMB's guidelines were published at 67 FR 8452 (February 22, 2002), and DOE's guidelines were published at 67 FR 62446 (October 7, 2002). DOE has reviewed today's notice under the OMB and DOE guidelines and has concluded that it is consistent with applicable policies in those guidelines.

List of Subjects in 10 CFR Part 626

Government contracts, Oil and gas reserves, **Strategic** and critical materials.

Issued in Washington, DC, on April 6, 2006.
Thomas D. Shope,
Acting Assistant Secretary for Fossil Energy.

For the reasons stated in the preamble, DOE hereby proposes to amend chapter II of title 10 of the Code of Federal Regulations by adding a new part 626 as set forth below:

PART 626--PROCEDURES FOR ACQUISITION OF **PETROLEUM** FOR THE **STRATEGIC PETROLEUM** RESERVE

Sec.

626.01 Purpose.

626.02 Definitions.

626.03 Applicability.

626.04 General Acquisition Strategy.

626.05 Acquisition Proce--General.

626.06 Acquiring Oil by Direct Purchase.

626.07 Royalty Transfer and Exchange.

626.08 Deferrals of Contractually Scheduled Deliveries.

Authority: 42 U.S.C. 6240(c); 42 U.S.C. 7101, et seq.

Sec. 626.01 Purpose.

This part establishes the procedures for acquiring **petroleum** for, and deferring contractually scheduled deliveries to, the **Strategic Petroleum** Reserve.

Sec. 626.02 Definitions.

Backwardation means a market situation in which prices are progressively lower in succeeding delivery months than in earlier months.

Contango means a market situation in which prices are progressively higher in the succeeding delivery months than in earlier months.

Contract means the agreement under which DOE acquires SPR **petroleum**, consisting of the solicitation, the contract form signed by both parties, the successful offer, and any subsequent modifications, including those granting requests for deferrals.

Contracting Officer means the person executing acquisition contracts on behalf of the Government, including the authorized representative of a Contracting Officer acting within the limits of his or her authority.

DEAR means the Department of Energy Acquisition Regulation.

Deferral means a process whereby **petroleum** scheduled for delivery to the SPR in a specific contract period is rescheduled for later delivery, outside of that period and encompasses the future delivery of the originally scheduled quantity plus an in-kind premium.

DOE means the Department of Energy.

Exchange means a process whereby **petroleum** owned by or due to the SPR is provided to a person or contractor in return for **petroleum** of comparable quality plus a premium quantity of **petroleum** delivered to the SPR in the future, or when SPR **petroleum** is traded for **petroleum** of a different quality for operational reasons based on the relative values of the quantities traded.

FAR means the Federal Acquisition Regulation.

Government means the United States Government.

International Energy Program means the program established by the

Agreement on an International Energy Program, signed by the United States on November 18, 1974, including any subsequent amendments and additions to that Agreement.

OPR means the Office of **Petroleum** Reserves within the DOE Office of Fossil Energy whose responsibilities include the operation of the **Strategic Petroleum** Reserve.

Petroleum means crude oil, residual fuel oil, or any refined product (including any natural gas liquid, and any natural gas liquid product) owned, or contracted for, by DOE and in storage in any permanent SPR facility, or temporarily stored in other storage facilities.

Secretary means the Secretary of Energy.

Strategic Petroleum Reserve or SPR means the DOE program established by Title I, Part B, of the Energy Policy and Conservation Act, 42 U.S.C. 6201 et seq.

Sec. 626.03 Applicability.

The procedures in this part apply to the acquisition of **petroleum** by DOE for the **Strategic Petroleum** Reserve through direct purchase or transfer of royalty-in-kind oil, as well as to deferrals of contractually scheduled deliveries.

Sec. 626.04 General acquisition strategy.

(a) Criteria for commencing acquisition. To reduce the potential for negative impacts from market participation, DOE shall review the following factors prior to commencing acquisition of **petroleum** for the SPR:

- (1) The current inventory of the SPR;
- (2) The current level of private inventories;
- (3) Days of net import protection;
- (4) Current price levels for crude oil and related commodities;
- (5) The outlook for international and domestic production levels;
- (6) Existing or potential disruptions in supply or refining capability;
- (7) The level of market volatility;
- (8) Futures market price differentials for crude oil and related commodities; and
- (9) Any other factor the consideration of which the Secretary deems to be necessary or appropriate.

(b) Review of rate of acquisition. DOE shall review the appropriate rate of oil acquisition each time an open market acquisition has been suspended for more than three months, and every six months in the case of ongoing or suspended royalty-in-kind transfers.

(c) Acquisition through other Federal agencies. DOE may enter into arrangements with another Federal agency for that agency to acquire oil for the SPR on behalf of DOE.

Sec. 626.05 Acquisition procedures--general.

(a) Notice of acquisition.

(1) Except when DOE has determined there is good cause to do otherwise, DOE shall provide advance public notice of its intent to

acquire **petroleum** for the SPR. The notice of acquisition is usually in the form of a solicitation. DOE shall state in the notice of acquisition the general terms and details of DOE's crude oil acquisition and, to the extent feasible, shall inform the public of its overall fill goals, so that they may be factored into market participants' plans and activities.

(2) The notice of acquisition generally states:

- (i) The method of acquisition to be employed;
- (ii) The time that the solicitations will be open;
- (iii) The quantity of oil that is sought;
- (iv) The minimum crude oil quality requirements;
- (v) The acceptable delivery locations; and
- (vi) The necessary instructions for the offer process.

(b) Method of acquisition.

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(1) DOE shall define the method of crude oil acquisition, direct purchase or royalty-in-kind transfer and exchange, in the notice of acquisition.

(2) DOE shall determine the method of crude oil acquisition after taking into account the availability of appropriated funds, current market conditions, the availability of oil from the Department of the Interior, and other considerations DOE deems to be relevant.

(c) Solicitation.

(1) To secure the economic benefit and security of a diversified base of potential suppliers of **petroleum** to the SPR, DOE shall maintain a listing, developed through on-line registration and personal contact, of interested suppliers. Upon the issuance of a solicitation, DOE shall notify potential suppliers via their registered e-mail addresses.

(2) DOE shall make the solicitation publicly available on the Web sites of the DOE Office of Fossil Energy <http://www.fe.doe.gov/programs/reserves> and the OPR <http://www.spr.doe.gov>.

(d) Timing and duration of solicitation.

(1) DOE shall determine crude oil requirements on nominal six-month cycles, and shall review and update these requirements prior to each solicitation cycle.

(2) DOE may terminate all solicitations and contracts pertaining to the acquisition of crude oil at the convenience of the Government, and in such event shall not be responsible for any costs incurred by suppliers, other than for oil delivered to the SPR.

(e) Quality.

(1) DOE shall define minimum crude oil quality specifications for the SPR. DOE shall include such specifications in acquisition solicitations, and shall make them available on the Web sites of the DOE Office of Fossil Energy <http://www.fe.doe.gov/programs/reserves> and the OPR <http://www.spr.doe.gov>.

(2) DOE shall periodically review the quality specifications to ensure, to the greatest extent practicable, the crude oil mix in storage matches the demand of the United States refining system.

(f) Quantity. In determining the quantities of oil to be delivered to the SPR, DOE shall:

(1) Take into consideration market conditions and the availability of transportation systems; and

(2) Seek to avoid adversely affecting other market participants or crude oil market fundamentals.

(g) Offer and evaluation procedures.

(1) Each solicitation shall provide necessary instructions on offer format and submission procedures. The details of the offer, evaluation and award procedures may vary depending on the method of acquisition.

(2) DOE shall use relative crude values and time differentials to the maximum extent practicable to manage acquisition and delivery schedules to reduce acquisition costs.

(3) DOE shall evaluate offers based on prevailing market prices of specific crude oils, and shall award contracts on a competitive basis.

(4) Whether acquisition is by direct purchase or royalty transfer and exchange on a term contract basis, DOE shall use a price index to account for fluctuations in absolute and relative market prices at the time of delivery to reduce market risk to all parties throughout the contract term.

(h) Scheduling and delivery.

(1) Except as provided in paragraph (4) of this section, DOE shall accept offers for crude oil delivered to specified SPR storage sites via pipeline or as waterborne cargos delivered to the terminals serving those sites.

(2) Except as provided in paragraph (4) of this section, DOE shall generally establish schedules that allow for evenly spaced deliveries of economically-sized marine and pipeline shipments within the constraints of SPR site and commercial facilities receipt capabilities.

(3) DOE shall strive to maximize U.S. flag carrier utilization through the terms of its supply contracts.

(4) DOE reserves the right to accept offers for other methods of delivery if, in DOE's sole judgment, market conditions and logistical constraints require such other methods.

Sec. 626.06 Acquiring oil by direct purchase.

(a) General. For the direct purchase of crude oil, DOE shall, through certified contracting officers, conduct crude oil acquisitions in accordance with the FAR and the DEAR.

(b) Acquisition strategy.

(1) DOE solicitations:

(i) May be either continuously open or fixed for a period of time (usually no longer than 6 months); and

(ii) May provide either for prompt delivery or for delivery at future dates.

(2) DOE may alter the acquisition plan to take advantage of differentials in prices for different qualities of oil, based on a consideration of the availability of storage capacity in the SPR sites, the logistics of changing delivery streams, and the availability of ships, pipelines and terminals to move and receive the oil.

(3) Based on the market analysis described in paragraph (d) of this section, DOE may suspend competition or reject offers on the basis of Government estimates that project substantially lower oil prices in the future than those contained in offers. If DOE determines there is a high probability that the cost to the Government can be reduced without significantly affecting national energy security goals, DOE may either contract for delivery at a future date or delay purchases to take advantage of projected future lower prices. Conversely, DOE may increase the rate of purchases if prices fall below recent price trends

or futures markets present a significant contango and prices offer the opportunity to reduce the average cost of oil acquisitions in anticipation of higher prices.

(4) Based on the market analysis described in paragraph (d) of this section, DOE may suspend the solicitation or refuse offers or decrease the rate of purchase if DOE determines acquisition will add significant upward pressure to prices either regionally or on a world-wide basis. DOE may consider recent price changes, private inventory levels, oil acquisition by other stockpiling entities, the outlook for world oil production, incipient disruptions of supply or refining capability, logistical problems for moving **petroleum** products, macroeconomic factors, and any other considerations that may be pertinent to the balance of **petroleum** supply and demand.

(c) Fill requirements determination.

DOE shall develop SPR fill requirements for each solicitation based on an assessment of national energy security goals, the availability of storage capacity, and the need for specific grades and quantities of crude oil.

(d) Market analysis.

(1) DOE shall establish a market value for each crude type to be acquired based on a market analysis at the time of contract award.

(2) In conducting the market analysis, DOE may use prices on futures markets, spot markets, recent price movements, current and projected shipping rates, forecasts by the DOE Energy Information Administration, and any other analytic tools available to DOE to determine the most desirable purchase profile.

(3) A market analysis supporting a suspension decision may consider recent price changes, private inventory levels, oil acquisition by other stockpiling entities, the outlook for world oil production, incipient disruptions of supply or refining capability, logistical problems for moving **petroleum** products, macroeconomic factors, and any other considerations that may be pertinent to

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the balance of **petroleum** supply and demand.

(e) Evaluation of offers.

(1) DOE shall evaluate offers using:

(i) The criteria and requirements stated in the solicitation; and
(ii) The market analysis under paragraph (d) of this section.

(2) DOE shall require financial guarantees from contractors.

Sec. 626.07 Royalty transfer and exchange.

(a) General.

DOE shall conduct royalty transfers pursuant to an agreement between DOE and the Department of the Interior for the transfer of royalty oil.

(b) Acquisition strategy.

(1) DOE and the Department of the Interior shall select a royalty volume from specified leases for transfer usually over six-month periods, beginning April 1 and October 1.

(2) If logistics and crude oil quality are compatible with SPR receipt capabilities and requirements respectively, DOE may take the royalty oil directly from the Department of the Interior and place it in SPR storage sites. Otherwise, DOE may competitively solicit

suppliers to deliver oil of comparable value to the SPR in exchange for the receipt of royalty-in-kind oil.

(3) If, based on the market analysis described in paragraph (d) of this section, DOE determines there is a high probability that the cost to the Government can be reduced without significantly affecting national energy security goals, DOE may contract for delivery at a future date in expectation of lower prices and a higher quantity of oil in exchange. Conversely, it may schedule deliveries at an earlier date under the contract in anticipation of higher prices at later dates.

(4) Based on the market analysis in paragraph (d) of this section, DOE may, after consultation with the Department of the Interior, suspend the transfer of royalty oil to DOE if it appears the added demand for oil will add significant upward pressure to prices either regionally or on a world-wide basis.

(c) Fill requirements determination.

DOE shall develop SPR fill requirements for each solicitation based on an assessment of national energy security goals, the availability of royalty oil and storage capacity, and need for specific grades and quantities of crude oil.

(d) Market analysis.

(1) DOE may use prices on futures markets, spot markets, recent price movements, current and projected shipping rates, forecasts by the DOE Energy Information Administration, and any other analytic tools to determine the most desirable acquisition profile.

(2) A market analysis supporting a suspension decision may consider recent price changes, private inventory levels, oil acquisition by other stockpiling entities, the outlook for world oil production, incipient disruptions of supply or refining capability, logistical problems for moving **petroleum** products, macroeconomic factors, and any other considerations that may be pertinent to the balance of **petroleum** supply and demand.

(e) Evaluation of royalty exchange offers.

(1) DOE shall evaluate offers using:

(i) The criteria and requirements stated in the solicitation; and

(ii) The market analysis under paragraph (d) of this section.

(2) DOE shall require financial guarantees from contractors prior to evaluation.

Sec. 626.08 Deferrals of contractually scheduled deliveries.

(a) General.

(1) DOE prefers to take deliveries of **petroleum** for the SPR at times scheduled under applicable contracts. However, in the event the market is distorted by disruption to supply or other factors, DOE may defer scheduled deliveries or request or entertain deferral requests from contractors.

(2) A contractor seeking to defer scheduled deliveries of oil to the SPR may submit a deferral request to DOE.

(b) Deferral criteria. DOE shall only grant a deferral request for negotiation if the Government can increase the volume of oil in the SPR and, if DOE determines, based on DOE's deferral analysis, that at least one of the following conditions exists:

(1) The Government can reduce the cost of its oil acquisition per barrel and increase the volume of oil being delivered to the SPR by means of the premium barrels required by the deferral process.

(2) The Government anticipates private inventories are approaching

a point where unscheduled outages may occur.

(3) There is evidence that refineries are reducing their run rates for lack of feedstock.

(4) There is an unanticipated disruption to crude oil supply.

(c) Negotiating terms.

(1) If DOE decides to negotiate a deferral of deliveries, DOE shall estimate the market value of the deferral and establish a strategy for negotiating with suppliers the minimum percentage of the market value to be taken by the Government.

(2) DOE shall only agree to amend the contract if the negotiation results in an agreement to give the Government a fair and reasonable share of the market value.

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