EXHIBIT V-1

240

Hunt, Edith

From: Kateiva, George
Sent: Wednesday, March 20, 2002 3:13 PM
To: COMMS
Subject: FW: BP Deferral Email

-----Original Message-----
From: Callahan, David
Sent: Wednesday, March 20, 2002 8:52 AM
To: Waggoner, Michael; Shourbaji, Nabil; Marland, Nancy (HQ); Gaillard, Rose; Kateiva, George; Habbaz, Roy
Cc: Gibson, Hoot; McWilliams, Michael; Landry, Gary
Subject: RE: BP Deferral Email

It would help our May-July schedule, but it would impact anything in the future. Don't see the need to defer now. Above based on the total amount owed. If we could move one cargo out of each of the months, that would help. See no change in the no deferral policy unless the price of oil increases. Recommend saying thank you, but not at the present time.

-----Original Message-----
From: Waggoner, Michael
Sent: Wednesday, March 20, 2002 8:33 AM
To: Callahan, David; Shourbaji, Nabil; Marland, Nancy (HQ); Gaillard, Rose; Kateiva, George; Habbaz, Roy
Cc: Gibson, Hoot; McWilliams, Michael; Landry, Gary
Subject: BP Deferral Email

Interest?

-----Original Message-----
From: Dyer, James T [mailto:DyerJ2@bp.com]
Sent: Monday, March 18, 2002 1:02 PM
To: Waggoner, Michael
Subject:

Mike

I know some time ago we discussed deferral of the current exchange barrels and you said that you no longer had any interest in this. Is this still the case? It appears that if we deferred the balance of our volume a year we could deliver another 500 kb or so, this also would defer the volume until after the RIK barrels, hence easing logistical issues. Also i wonder whether the politicians might be keen given the rise in prices that we are currently seeing.

Let me know if this is of interest.

rgds

Hunt, Edith

EXHIBIT V-2

241

From: Kateiva, George
Sent: Monday, March 25, 2002 6:49 AM
To: COMMS
Subject: FW: BP Deferral Email

-----Original Message-----
From: Marland, Nancy (HQ)
Sent: Thursday, March 21, 2002 10:50 AM
To: Callahan, David; Waggoner, Michael; Shourbaji, Nabil; Marland, Nancy (HQ); Gaillard, Rose; Kateiva, George; Habbaz, Roy
Cc: Gibson, Hoot; McWilliams, Michael; Landry, Gary
Subject: RE: BP Deferral Email

Deferrals in general were discussed in our PR staff meeting this morning, with Hoot in attendance. John Shages said he wanted to discuss with the National Security Council to make sure he understood what the White House's reaction would be if prices were to go up to the politically sensitive level of $30/bbl or so. I think the issue is not totally closed and will be discussed further by management.

-----Original Message-----
From: Callahan, David [mailto:David.Callahan@SPR.DOE.GOV]
Sent: Wednesday, March 20, 2002 9:52 AM
To: Waggoner, Michael; Shourbaji, Nabil; Marland, Nancy (HQ); Gaillard, Rose; Kateiva, George; Habbaz, Roy
Cc: Gibson, Hoot; McWilliams, Michael; Landry, Gary
Subject: RE: BP Deferral Email

It would help our May-July schedule, but it would impact anything in the future. Don't see the need to defer now. Above based on the total amount owed. If we could move one cargo out of each of the months, that would help. See no change in the no deferral policy unless the price of oil increases. Recommend saying thank you, but not at the present time.

-----Original Message-----
From: Waggoner, Michael
Sent: Wednesday, March 20, 2002 8:33 AM
To: Callahan, David; Shourbaji, Nabil; Marland, Nancy (HQ); Gaillard, Rose; Kateiva, George; Habbaz, Roy
Cc: Gibson, Hoot; McWilliams, Michael; Landry, Gary
Subject: BP Deferral Email

Interest?

-----Original Message-----
From: Dyer, James T [mailto:DyerJ2@bp.com]
Sent: Monday, March 18, 2002 1:02 PM
To: Waggoner, Michael
Subject:

Mike

I know some time ago we discussed deferral of the current exchange barrels

and you said that you no longer had any interest in this. Is this still the case? It appears that if we deferred the balance of our volume a year we could deliver another 500 kb or so, this also would defer the volume until after the RIK barrels, hence easing logistical issues. Also i wonder whether the politicians might be keen given the rise in prices that we are currently seeing.

Let me know if this is of interest.

rgds

Hunt, Edith

EXHIBIT V-3

243

From: Kateiva, George
Sent: Monday, April 01, 2002 9:43 AM
To: DMCOL
Subject: FW: BP Deferral Request

Follow Up Flag: Follow up
Flag Status: Flagged

FYI

-----Original Message-----
From: Waggoner, Michael
Sent: Monday, April 01, 2002 9:34 AM
To: Callahan, David; Shourbaji, Nabil; Kilroy, John; Marland, Nancy (HQ); Kateiva, George; Habbaz, Roy; Gaillard, Rose
Cc: Gibson, Hoot; McWilliams, Michael; Landry, Gary
Subject: FW: BP Deferral Request

FYI

-----Original Message-----
From: Dyer, James T [mailto:DyerJ2@bp.com]
Sent: Monday, April 01, 2002 9:18 AM
To: Waggoner, Michael
Subject:

Morning Mike.

Happy Easter!!! I know that you said last week that the government would have no interest in deferring the exchange barrels but the oil price does keep rising. As of this morning we calculate a years deferral would be worth an extra 750,000 bbls to you.

I'm not trying to bug you on this, but just wanted to make sure you knew of the opportunity.

Regards

Options for Filling the Strategic Petroleum Reserve

Background: After the events of September 11, 2001, President Bush determined that the Strategic Petroleum Reserve should be filled to its capacity primarily using royalty oil from Federal leases on the Outer Continental Shelf. The SPR Office is taking royalty oil from leases and additionally is taking deliveries of oil from earlier phases of a royalty oil transfer program and oil being returned from the September 2000 exchange of 30 million barrels.

Thirty six million barrels of oil are scheduled for deliveries in specific months from June 2002 through April 2003. Because of additional transfers from the Department of Interior, another million barrels per month will be added from November 2002 through April 2003. Beginning May 2003, deliveries will be stable at around 3.5 million barrels per month, based on the expected rate of transfers from DOI.

Although contractual schedules are fixed, the Government has latitude to renegotiate the delivery dates, thereby creating policy options. Prior to the events of September 11, 2001, the SPR Office routinely renegotiated delivery dates. The business model of trading more delivery time for increased volumes of oil was characterized by reduced costs, conformance with normal private sector practices, logistical flexibility to accommodate busy terminals or maintenance requirements at the sites, and acceptance by all of the companies with contracts. In February 2002, the SPR Office received a request to defer deliveries of 9 million barrels of oil for a year. The initial offer of extra oil in consideration of the deferral was valued at $18 million. In order to stay in conformance with the President's highest priorities, the SPR Office asked the Administration for guidance prior to negotiating for this deferral, and the Secretary after conferring with the White House announced we were planning to take oil deliveries on schedule without deferrals. The reasoning for turning away from a successful business model was not made public, however, the most plausible explanation is a desire to have as much oil in the SPR as fast as possible for national security or energy security reasons.

Options

Add Oil to the Reserve as It Becomes Available Under Contract

The most straightforward option is to take delivery of all oil owed to the SPR according to contract schedules and to inject it as it becomes available. Its primary appeal is that inventory increases every month and inventory will be at the highest possible level at every moment (absent funds to buy oil) until the Reserve is filled in early 2005.

The primary criticisms of this option are:

It ignores market signals: The SPR doggedly adds oil to the Reserve, not slowing for high prices nor accelerating to take advantage of low prices. This leads to a high average cost per barrel, and does not take advantage of a chance to reduce the budget deficit.

It ignores economic conditions: Whatever impact the acquisition process has on prices, it is allowed to happen whether the economy is robust or bordering on recession.

It is not consistent with a high sense of urgency to fill the Reserve, since the option of buying oil using appropriated funds could fill the Reserve to capacity much faster.

Alternative Fill Rate Rules

There are many variations on the theme of accelerating acquisition when prices are low and slowing when prices are high. Through 2001, the SPR Office assessed offers from contractors, and if the offers gave enough of the market value of the deferral to the Government, the offers were accepted.

There are a number of criticisms of this option:

Market interference: If the Government does not follow a simple rule for acquisition, it will be actively influencing prices. Even if this activity were not objectionable in principle, the fill rate of the SPR is too little to have more than marginal impacts on price.

Lack of economic impact: Even if the acquisition increased price, the change is insufficient to effect macroeconomic conditions, and, therefore, this should not be a consideration.

Delayed fill: We should get as much oil in the Reserve as rapidly as possible. Alternatives that potentially postpone fill are dangerous for the primary objective.

Main Areas of Debate

Markets and Government Participation: The SPR Office acknowledges the concern that the Government should not manipulate the market, and asserts its normal business practice does not manipulate the market, but instead conforms with the goal of the Energy Policy and Conservation Act that the acquisition should minimize impact on market forces.

Crude oil markets are free to move according to the dictates of many players, however, they are not perfectly free markets. OPEC members and exporting countries cooperating with OPEC and Iraq are colluding to set production volumes and prices. If controlled prices were always high, low, or consistent there would be offsetting benefits to this interference in the market. Instead, OPEC et al act erratically, sometimes driving prices low to make high-cost U.S. oil production uneconomic as occurred in 1998. At other times prices are kept too high and hinder economic growth, as in 2000 and 2001. Despite OPEC's contention that it is seeking price stability, history suggests OPEC actually enforces production stability, allowing prices to swing widely. The simple rule of taking SPR oil as it is contractually due exaggerates this OPEC pattern, since the SPR takes the same volume regardless of price. It is a business model different from all private market

participants, and if followed by a significant number of market participants would leave to explosive price swings.

The SPR Office proposes a return to the SPR oil acquisition business model, allowing deferrals which will always be counter-cyclical to OPEC induced price volatility. Since there would be consistency in our behavior, markets would not be surprised, and contractors would be comfortable knowing that the Government was acting in a rational business-like manner. Acquiring less oil in high price markets and more oil in low price markets is such ordinary behavior, it would have much less impact on market forces than does the practice of ignoring price and acquiring just as much oil at high prices as at low prices.

Inconsequential volumes: If we look at the SPR from the perspective of daily supply and demand, the SPR fill rates are inconsequential. The fill rate is 100-170,000 barrels per day compared to world production and consumption of 75 million barrels per day. However, when OPEC countries are determined to maintain discipline in their export quotas, the cumulative impact of filling the SPR becomes more significant when compared to U.S. and Atlantic basin inventories. Essentially, if the SPR inventory grows, and OPEC does not accommodate that growth by exporting more oil, the increase comes at the expense of commercial inventories. Most analysts agree that oil prices are directly correlated with inventories, and a drop of 20 million barrels over a 6-month period can substantially increase prices. The EIA analysis later in this paper alludes to the power to inventory changes in changing prices within a few weeks and months, and the price impact of the weekly release of API and EIA inventory statistics is testimony to the power of inventory change in determining prices. A variation of 3 or 4 million barrels from expected inventory can change prices more than a dollar per barrel during a day. Clearly, a change in private inventories equal to the SPR inventory change could have a substantial price impact.

Economic Impacts: Historically, studies of the SPR, recognize three benefits of selling the oil at the time of an emergency. The most important and powerful of the three is referred to as the Gross Domestic Product (GDP) effect. When oil supplies are disrupted and oil prices spike, the emergency nature of the situation causes the domestic economy to slow for a variety of reasons. It is often observed that every recession since World War II has been preceded by an oil supply disruption. However, cyclical price increases, not caused by disruptions do not have the same impact on economies. Therefore, proponents of the option of filling the Reserve at a constant rate argue there is no reason to modify fill rates even if you perceived a rise in prices.

The SPR Office agrees that cyclical price changes do not have the same economic effect as price shocks. Nevertheless, the SPR Office advocates counter cyclical activities by the agencies of government that have tools for that purpose. Since it is known that selling oil is an economic stimulant and removing oil from the market is an economic depressant, it seems that it would be good public policy if oil acquisition were to take during robust growth and deferred when the economy is in a cyclical downturn.

There are a number of reasons supporting the deferral of acquisitions may help the economy, at least directionally, if not forcefully.

The oil price change will prevent an excessive redistribution of domestic purchasing power away from consumers of oil and natural gas products. Based on 20 million barrels per day of consumption, a $1 per barrel price drop will preserve economic purchasing power of over $7 billion per year – equal to a modest tax cut. In the current fragile economic expansion characterized by strong consumer demand but weak capital spending, a falling stock market and uncertain investment environment, providing the consumer with the means to continue spending is good economic policy.

If oil imports for the SPR are delayed, the balance of trade improves in the short term. In the current circumstances, a balance of trade improvement would be welcome. Specifically, the U.S. dollar is falling in value, which mayl have very negative impacts for the economy in the form of inflation. Reducing oil imports, and the imbalance in trade takes pressure off the U.S. dollar, and reduces the incentive for the Federal Reserve to increase interest rates with the goals of suppressing inflation and supporting the dollar. While this effect is admittedly small, it is directionally helpful.

There are two other benefits to the drawdowns that do apply to a normal market. First, all oil coming into the SPR is imported, and the change in price caused by a reduction in oil demand will lower the cost of imports. If deferrals of SPR deliveries were to reduce prices by $1 per barrel, the import cost of oil to the U.S. will drop $10 million per day, or $3.6 billion per year. This is a direct measurable benefit to the American people.

The last benefit that occurs when the SPR sells oil in an emergency is that the U.S. will make a profit on the oil it bought at a lower price. Buying oil at a lower average price has the equivalent benefit. If the SPR can average down the price of oil it injects in the Reserve by $1 per barrel between now and 2005, the U.S. Treasury will be better off by $125 million, a direct benefit.

There are also programmatic reasons for wanting to lower the average cost of oil added to the Reserve. As a matter of public stewardship, the SPR has been (sometimes fairly) accused of buying oil at high prices and selling low. If the SPR can use a rule for oil acquisition that lowers the average cost, it is more likely the program can show a financial profit rather than a loss, a result that would enhance the Department's image and employee morale.

The Department is planning to starting a study of SPR size either on its own, or in response to the provision in the Senate Energy Bill about to go to conference, requiring such a study within 6-months of enactment. In the cost benefit analysis associated with that study, the price of oil is a powerful determinant of the outcome of the study. If the Department can institute a rule for acquisition that lowers its cost, the projected net benefits of expanding beyond 700 million barrels will be improved. The opportunity for this cost reduction is documented. Using its business model to renegotiate delivery dates for SPR oil that was owed to the Department in 2000 and 2001, the SPR Office was able

to raise 7 million barrels of premiums in exchange for the delays, on a base of less than 50 million barrels of oil. At a current market value of $25 per barrel, the deferral reduced costs by $175 million. Reducing the cost of oil acquisition will radically alter the terms of debate for any future expansion of the Reserve.

The Issue of Urgency to Fill:

As noted above the strongest argument against renegotiating delivery schedules is that there is urgency to fill the Reserve to its capacity. However, given the current outlook for OPEC exports, and commercial inventories, it appears to the SPR Office the Government should be indifferent to deliveries of the outstanding oil accounts receivable in 2002 or 2003. If in fact, a major event is likely to occur within the next year that will cause an energy supply emergency, it is arguably superior to have the

EXHIBIT V-5

From: Kateiva, George
Sent: Monday, November 19, 2001 6:24 AM
To: COMMS
Subject: FW: SPR royalty transfer update

-----Original Message-----
From: Marland, Nancy
Sent: Friday, November 16, 2001 9:04 AM
To: Shourbaji, Nabil; Landry, Gary; Waggoner, Michael; Callahan, David
Subject: FW: SPR royalty transfer update

fyi

-----Original Message-----
From: Shages, John
Sent: Friday, November 16, 2001 9:17 AM
To: LeMat, Lynnette; Marland, Nancy; Johnson, David
Subject: FW: SPR royalty transfer update

-----Original Message-----
From: Blake, Francis
Sent: Friday, November 16, 2001 8:03 AM
To: Shages, John
Cc: Kripowicz, Robert; Furiga, Richard; Card, Robert
Subject: RE: SPR royalty transfer update

ok

-----Original Message-----
From: Shages, John
Sent: Thursday, November 15, 2001 6:23 PM
To: Blake, Francis
Cc: Kripowicz, Robert; Furiga, Richard; Card, Robert
Subject: SPR royalty transfer update

Frank: We held a meeting today with the Minerals Management Service heirarchy today. They allowed Steve Griles gave them clear instructions that if oil prices spike, and it becomes desirable to stop filling the SPR, the MMS should stop the transfer of royalty oil to DOE. We made the case for continuing the transfer and allowing DOE to manage the delivery schedule to eliminate the unwanted demand. They immediately said the issue would have to resolved by you and Steve Griles, and then reviewed by the White House. They proposed writing an issue paper for you and Steve Griles, and we have agreed to do that jointly with them. While we believe the pros and cons of this issue are obvious, MMS feels they need some time to prepare their position and asked for November 28 as a date to have the paper ready for delivery to you, and we also agreed to that.

John Shages

EXHIBIT V-6

From: Kateiva, George
Sent: Monday, November 19, 2001 6:22 AM
To: COMMS
Subject: FW: MMS RIK Meeting

-----Original Message-----
From: Marland, Nancy
Sent: Thursday, November 15, 2001 2:02 PM
To: Roy Habbaz (E-mail); Kateiva, George
Subject: FW: MMS RIK Meeting

fyi, if you don't have already.

-----Original Message-----
From: LeMat, Lynnette
Sent: Thursday, November 15, 2001 11:32 AM
To: Shourbaji, Nabil; Callahan, David; Waggoner, Michael; Landry, Gary; Marland, Nancy; Giles, Harry
Subject: MMS RIK Meeting

MMS has direction from their Deputy Secretary to fashion a program which would involve the termination of contracts when a certain trigger price for oil is reached. This differs from the direction from Deputy Secretary Blake which I forwarded you this morning. Since neither group can commit to a position opposed to their Deputy Secretary's position, we agreed to write a paper including both options which will be forwarded to our Deputy Secretaries to work out. Our respective options are to be completed by November 26 and the group will meet again November 28. Therefore, it looks like a technical meeting is more convenient for MMS December 6 or 7 but Milton Dial will confirm that later today. Perhaps we will be able to have a telephone meeting sooner.

[redacted]

EXHIBIT V-7

MEMORANDUM FOR

FROM

SUBJECT: Decision request on the rate of fill for the Strategic Petroleum Reserve (SPR)

ISSUE: The Department of Energy (DOE) has a schedule for filling the SPR between now and early 2005. DOE has the option of entertaining offers to delay deliveries in return for bonus barrels of oil which could relieve the speculative oil market. It also has the option of accelerating fill if supplemental appropriations are requested.

SENSITIVITIES: Economic, budget, energy security, foreign, market signals

BACKGROUND: The SPR has had an oil accounts receivable since April 1999. Monthly deliveries to the SPR by contractors are scheduled by the terms of contracts. Under certain market conditions, it is advantageous for both the Government and the contractors to renegotiate deliveries to later dates. During 2000 and 2001, whenever these conditions arose, the SPR Office agreed to later delivery dates in exchange for more oil. Renegotiation of delivery dates, if proposed by contractors, in exchange for more oil is the standard business practice for SPR oil acquisition.

In November, in response to the events of September 11, 2001, the President determined to fill the Strategic Petroleum Reserve to its capacity using primarily royalty oil from Federal leases in the Gulf of Mexico. We have been emphasizing the importance of this decision for energy security reasons. The rate at which the Department of Interior can deliver royalty oil to DOE is limited; the current transfer rate is 60,000 barrels per day. The rate is scheduled to increase by October, with a potential maximum of 130,000 barrels per day. At those rates, the SPR will be filled to capacity in early 2005.

From November 2001 until recently, market conditions favored taking delivery of oil according to schedule. During the first quarter 2002, SPR added 11.4 million barrels to inventory. The scheduled deliveries for the remainder of 2002 range from 3-5 million barrels of oil per month. Now, due to events in the Middle East, market concern over Iraq, and the cumulative impacts of OPEC production restraints, prices for oil from now through the summer are significantly higher than prices for oil deliveries one year in the future. This market condition favors contractors offering to renegotiate deliveries to a later date. DOE has received an offer to pay an additional 750,000 barrels of oil in exchange for rescheduling 9 million barrels to one year later. Normally, DOE would negotiate based strictly on economic considerations, but current conditions require consideration of energy security, international relations, budget and market signals as well.

DISCUSSION: Deferrals of deliveries have saved the U.S. a significant sum of money. Deferrals of 31.17 million barrels owed to the SPR in Fall 2001, gave SPR an additional 3.45 million barrels without additional cost. Similarly, SPR was owed 27.13 million barrels of oil spread throughout 2000 from a Royalty Oil transfer program that ran from 1999 through 2000. After renegotiation for later delivery, the volume increased by 3.55 million barrels. If we value these premium barrels at $25 per barrel, they have reduced costs by $175 million. The potential for savings to the Treasury if we continue to follow this business model until the Reserve is full is additional hundreds of millions of dollars.

Economic impacts: The latest surge in oil prices is not welcomed by the world's oil importing economies, most of which are just beginning to recover from recession. If prices stay artificially high due to a war premium, recovery will be slowed everywhere including the U.S.. Renegotiating deliveries now scheduled for May, June and July would ease U.S. oil demand and relieve some speculative pressure from the oil market.

Energy Security: From an energy security perspective, rescheduling deliveries could delay filling the SPR. Current inventory is about 560 million barrels, and the initial drawdown rate is 4.2 million barrels per day. At a 700 million barrel inventory, the initial drawdown rate will increase to 4.4 million barrels per day, and the inventory would equate to approximately 64 days of net U.S. imports compared with 51 measured at the end of 2001. Part of U.S. security depends upon coordination with other stockpiling consumer countries. While the U.S. has roughly half of the world's government owned and controlled stockpiles, the dispersed nature of the other stockpiles allows them to be drawn quickly. In total, International Energy Agency member countries, including the U.S. have a drawdown capacity in the first month of over 12 million barrels per day.

Budget and Fiscal Impact: The current program has no budget impact since the royalty oil is transferred from the Department of the Interior administratively. The actual cost to the Treasury of adding 108 million barrels of oil to the SPR per the President's direction is about $2.7 billion in foregone revenues. Choosing to renegotiate the delivery dates would have no budget impact, but would reduce the cost to Treasury, potentially by a few hundred million dollars over time. If we decide, for economic security reasons, to accelerate fill, we would ask the Congress for a supplemental appropriation for FY 2003 of about $2 billion, and the fill rate during 2003 would be accelerated to 300,000 barrels per day.

Foreign Relations: The tense state of world affairs would cause any deviation from the status quo to be over analyzed by the press and foreign governments. Both renegotiating deliveries to later dates or announcing an acceleration of fill could be interpreted to mean the U.S. expected an expansion of world hostilities. Delaying deliveries could be seen as an indication of trouble in the immediate future, whereas accelerating fill could be seen as an indication of trouble in 2004-5.

Market Signals: Renegotiating the delivery dates might be interpreted as a move by the Government to deflate the "war premium" or speculative portion of the recent oil price rise.

If we chose to accelerate fill, we would depend upon the exporting countries to increase their production to accommodate the SPR fill. Otherwise, a fill rate of 300,000 barrels per day during all of 2003, would reduce commercial inventories significantly, raise prices and have a negative impact on the oil importing economies of the world.

PROS AND CONS

Option 1. Do not entertain offers to renegotiate delivery dates

Pros: Sends no signals to producing countries or allies

Fills the SPR at an even rate between now and 2005

Does not raise any speculation that the Administration is willing to meddle in the market

Cons: Deviates from the normal SPR business practice

SPR fill would continue even if markets become distressed or highly speculative

Option 2. Renegotiate delivery dates

Pros: Reduces the program cost to Treasury, with a potential in the hundreds of millions of dollars

Acts automatically to counteract market volatility by increasing demand when prices are relatively low and reducing demand when prices are relatively high

Acts to mitigate an unwelcome price rise while the world's economies are only beginning to recover from recession

Could be viewed favorably by consumers

Cons: Delays the addition of oil to the SPR, with energy security implications

May appear to be a market intervention or an attempt to challenge OPEC in controlling market inventories and prices

Could be viewed as an accommodation to "big oil"

Option 3. Do not renegotiate delivery dates and fill to capacity by the end of 2003

Pros: Advances the increase in potency of the SPR by one year

Sends a signal to other stockpiling countries encouraging them to add to inventories

Cons: Requires a major appropriation for FY 2003

Increases the SPR fill rate sufficiently to raise world oil prices significantly absent an accommodation by exporting countries

Sends a loud signal that the U.S. is putting a premium on near term energy security, which might be interpreted as preparation for increased hostilities

Renegotiation of Delivery Dates for Strategic Petroleum Reserve Oil

Desired Action: Allow the Strategic Petroleum Reserve (SPR) Office to resume negotiations of delivery dates for oil that is contracted for delivery on certain future dates.

Background: In October and November 2000 the SPR delivered 30 million barrels of oil to contractors. Those contractors were obligated to return 31.33 million barrels between August and November 2001. However, BP which had contracted for 9 million barrels of oil has already renegotiated the delivery of 9 million barrels, and in exchange for the delay until 2002 is giving the SPR an extra 700,000 barrels of oil.

The SPR Office has also been routinely renegotiating delivery dates for oil that is owed to the Department as part of the Royalty in Kind (RIK) transfer program that existed in 1999-2000. Over those two years, renegotiation of delivery dates has increased the amount of oil the Department will receive by another 2 million barrels. While the RIK program and the 2000 exchange program are different in philosophy, the mechanics of accepting oil and negotiating delivery dates are identical.

Advantages to renegotiating delivery dates:

- This is very business like. The private sector does not build inventories when current prices are high relative to future prices. High value scheduled for near-term delivery is frequently exchanged for greater volumes of oil to be delivered when prices are lower.

- Rescheduling deliveries increases the inventory of the Reserve without fiscal expense, thereby satisfying a strategic goal and doing it efficiently. The Department does not have appropriations to buy oil, and this is one of only a few feasible methods of acquistion.

- Speed is essential. Delayed deliveries are only valuable to industry when future prices are low relative to current prices. That condition has existed for almost two years, but the prices are moving in the direction of equality, and the opportunity may evaporate.

- This practice testifies to serious management by bringing down the average cost of oil in the Reserve.

- This is good public policy. Commercial petroleum inventories are low, retail product prices are high and economic growth is slow. The Government should avoid acquiring oil for the Reserve under these circumstances. Deliveries can be successively renegotiated until inventories are normal, near-term prices are low and the economy is growing strongly. Insisting on deliveries to the SPR during in a tight market would be heavily criticized as mismanagement and would be difficult to defend.

- This is equitable. The Department has been willing to negotiate with the contractors for all of the royalty in kind oil and with BP for nine million barrels of exchange oil. Other contractors can offer the Department equally profitable proposals.

Memorandum to Paul Leiby
From: John Shages
June 5, 2002
Subject: Economic Impacts of Filling and Deferred Filling of the SPR

Paul: Thanks for the thoughts on the deferral issue you laid out in your May 28, memorandum. Since I am writing a paper on the subject, your ideas have helped clarify my thinking. For your benefit, but also as an exercise to make sure my own thoughts are clear, I am writing to address each of the points you made in anticipation they will be raised again by other players in the game.

Generally, I don't know how to measure the impacts of small changes, but as with so many things economic, we can be fairly certain of the direction of impacts. If nothing else, I intend to highlight what should be directional improvement even if I can't quantify the situation.

This Mini-Study Proposes to Change the Terms of Debate on the SPR

- It has long been the DOE/SPR position that filling the SPR has small-to-no social effects or costs (beyond the direct costs), because
  - The proposed fill rates are all small compared to the amounts of excess oil capacity in the market, and the response of the market to such a small disturbance is ambiguous; and
  - The macro-economic dislocation associated with a small (less than $1/bbl) price change under normal, smoothly function markets with full anticipation of a pre-announced and steady fill rate, would surely be small, and certainly be undetectable with any possible empirical method.

Response: It's a mistake to think that the fill program always has minimal impact. Since impacts always occur at the margin, it is important to know the state of affairs at the time the SPR adds its marginal demand. A key consideration is whether OPEC is in a disciplined or undisciplined phase. If OPEC has the will to stick to a quota that will cause an inventory drop, then filling the SPR will accelerate the private sector inventory drop. Excess capacity in OPEC members is assumed to come on line during a disruption and SPR drawdown, but during a time when SPR is considering filling, excess OPEC capacity can as easily be assumed to be unavailable by definition of the OPEC cartel goals. Given OPEC behavior over the last 18 months, I believe OPEC is not accommodating economic growth, much less an inventory drop caused by SPR fill. It also seems that the role of private inventories in determining oil prices is under-appreciated relative to immediate supply/demand imbalance. Joann Shore regressed oil prices against inventory levels and there is a very strong inverse correlation. If you accept the assumption of an intransigent OPEC, then the impact of SPR fill on inventories is not a seemingly innocuous 100,000 barrels per day, but a powerful 30 million barrel reduction of private inventory over 10 months.

Similarly, the macro-economic impact of the change is at the margin. If the economy is robust, or even mildly expansionary, I would agree a $1 per barrel price change would not have a noticeable impact --- the price increases of 1999 were easily accommodated. However, in the current

situation, where the only strong sectors of the economy are housing and consumer spending, and the economic recovery is nascent and weak, I believe that marginal changes such as a $1 dollar oil price change can make big differences. For example, the dollar is falling fast, and SPR fill adds directly to imports in the calculation of the balance of trade. If we defer, we would immediately improve the situation to the tune of about $250 million per month; possibly inconsequential but also certainly an improvement that might impress currency traders and directionally help stabilize the dollar.

In the current situation, I wouldn't ignore any stimulation tool, regardless of potency.

Need to Recognize Distinction Between Effects of Filling and Drawing-down SPR

- Evaluating fill effects with essentially the same framework we use to evaluate drawdown benefits (i.e., estimating oil price changes with a very low short-run market price elasticity and then applying the elasticity of GDP with respect to oil price) would be likely to significantly overestimate the price effect, and would lead to a completely unreliable and highly exaggerated estimate of GDP effects.

Response: I agree totally, and I don't propose any specific GDP elasticity effect because I don't have a theoretical explanation of how the price drop will help. Nevertheless, the down side risks to the economy are myriad, and the chances of over stimulation are nil, therefore, leading me to the conclusion to use the deferrals as a stimulus regardless of the potency.

- It is *very* important to distinguish qualitatively between the expected economic effects of SPR drawdown and SPR filling. The economic effects of a drawdown during a disruption derive from anticipated changes in market price of oil, and the possible macroeconomic consequences of those price changes. During an oil supply emergency, price changes can be large and unexpected. An SPR drawdown could add as much as 5% to world oil supply, significantly buffering the oil price shock.

Response: Think of the deferrals not as a daily flow, but as a change to projected inventory in the private sector. If, come December 2002, U.S. private inventories are down 30 million barrels of crude oil, we will have higher prices, nervous traders, a more confident OPEC and an IRAQ that can cause price gyrations by deciding not to renew its export agreements for a month.

- In contrast to drawdown, when filling the SPR price changes are likely to be modest, gradual, and sustained. Filling the SPR alters oil balances by 0.1% to 0.2% (for a 75 to 150 MMB fill rate). Under normal market conditions, the price effect of a SPR fill is ordinarily small and ambiguous, given that supply and demand are functioning smoothly, have many months to respond, and there is substantial excess capacity.

Response: The critical assumption here is "normal market conditions." For too long the opponents of using the SPR have bifurcated markets into disrupted, emergency situations versus normal. I am of the opinion that a normal market would be when the members of OPEC are producing up to their capacity as long as the price is above marginal cost. First, we are very rarely in that condition, and second it would be disastrous for our domestic industry and the environment if we were there. Instead, we are in an OPEC cartel controlled market, but there is no consistency in OPEC policy. Therefore, I argue there is no magic dividing line between a normal market and a disrupted market, but a continuum of prices that reflect an increasing or decreasing degree of interference (read disruption) by the cartel. A discussion of when the supply and price go from

being normal to disrupted is only meaningful in the legal sense of the President needing to make a finding of an energy supply emergency. I believe that the full range of indicators of economic well being need to be considered when we make the assessment that we have crossed the line. At this moment oil prices are moderate, but a month ago they were too high. I base that judgment on the degree of backwardation in the futures market and the general state of the economy. This is a lead-in to my proposal that the degree of backwardation in the futures market should be the determining factor in deciding whether or not to defer deliveries.

- Moreover, we can be confident that even if a limited oil price increase occurs, a price impact of that level is very unlikely to result in macroeconomic dislocation, or measurable GDP losses of any kind. The macro-economic dislocation associated with a small price change under normal, smoothly function markets with full anticipation of a pre-announced and steady fill rate, would surely be small, and certainly be undetectable with any possible empirical method. Note that the most recent empirical analysis of the oil-macro link emphasize that the dislocation seems to follow from price excursions that are outside the recent price range or norm. From 1990 to 2001, the average refiners acquisition cost of imported crude has had a monthly standard deviation of $4.65. Thus, even if the SPR fill would raise prices by $1, this would only be a "shock" of less than 1/4th of a standard deviation, far too small to disrupt firms, consumers, or investors.

Response: I fully agree that we will never be able to measure the impact of deferrals, because they will be small. Nevertheless, given the state of the U.S. and world economies, I believe that directionally this is the right thing to do. Given the potential for the U.S. to have a decade that could look like the Japanese economy of the 1990's, I don't want to leave any tool for stimulation on the shelf regardless of its weight.

- The recognition that SPR fill effects differ not only in degree but in *nature* from draw effects is critical to the argument for a government emergency reserve. If the costs of SPR fill are believed to be symmetric to the benefits of SPR draw, but simply smaller in magnitude in direct proportion to the magnitude of the associated oil flow, then filling the SPR could never be worthwhile. The cumulative costs of a gradual SPR fill would counterbalance any possible benefits from drawdown. In fact, costs would outweigh the benefits since drawdown benefits are doubly-reduced by probability-weighting and discounting, since they are uncertain and delayed by years. The expectation that the SPR can be filled slowly with little-to-no effect on market price, and insignificant macroeconomic spillover costs, is central to the conclusion that stockpiling can yield a positive expected net present value.

Response: Agreed, but the way I read your view, I again see it as a case of average versus marginal analysis. First, we have 570 million barrels of inventory; that volume is not in play. It is a volume that covers most disruption scenarios. Second we are going to fill to a 700 million barrel inventory by 2005. The volume subject to deferrals at this moment is 42 million barrels, and the period of deferral might be a year. If you ran the disc-risk model and postponed the incremental fill by one year (made 2002 fill equal to zero but increased 2003 fill by the same volume) how would the value of the Reserve change? I venture to say almost not at all, because the chances of drawing all the oil in the Reserve during the year delay are minute. Furthermore, if I knew we were going to have a massive disruption starting in January 2003, given my assumption that OPEC does not accommodate SPR fill with more production, I would doubly insist on deferral because I would rather see a build in private inventories than in SPR inventories.

Here is a more concrete consideration. During 2000-1 we deferred deliveries of approximately 50 million barrels of oil. In exchange we were given 7 million barrels of oil as premia. Since

some of the deferrals were for more than one year we can't take a straight ratio, but for illustration let's say we received a 10 percent annual return. That return is a direct cost reduction. It is my contention we can institutionalize that cost reduction by making deferrals during periods of backwardation our normal business model. The consequence of that change is that you can go back to the disc-risk model, and for what-ever EIA oil price vector you have during the oil acquisition phase, reduce it by 10 percent. Run the model again, and it is obvious that the model is going to suggest a larger optimal size for the Reserve.

Alternative Approach to Deferral Analysis: Rely on Private Responses to the Market, and Focus on the Social "Insurance" Implications of Deferral

- It may be helpful to couch the planned analysis in terms of the social effects of *fill deferral* rather than the social effects of *filling* the SPR. The social costs of deferral stem largely from the temporary reduction or delay in the protection afforded by the SPR. The social benefits of deferral stem from the prospects for slightly larger deliveries of oil to the reserve by private firms later, in exchange for the right to defer. Simple estimates of the cost of delaying protection from delaying fill, and the benefits of added protection by filling more later, can be constructed from the existing size study cases.

Response: Agreed, but as noted above, if I can get a significant cost reduction from the deferral, I believe it will overwhelm the gap in the insurance since we are only protecting ourselves against the big or long lived disruption during a short time period.

- It is reasonable to posit that in the matter of fill planning the government's, and society's, principal interest resides in the weighing of these considerations regarding the timing and magnitude of SPR "insurance" coverage.

Response: Agreed.

- In the absence of a clear indication that fill deferral is needed to avoid an adverse impact on the market, deferral considerations having to do with a detailed assessment of market conditions, current and prospective private inventory levels and/or futures spreads, and the fine tuning of delivery schedules on the basis of anticipated market conditions, are arguably best left to the private sector. Thus, one approach the SPR Office could take is to leave it to private sector firms to perform the market analyses they need to determine whether they wish to request fill deferral, while the government could establish the terms for a fill deferral based on its estimate of the tradeoff between foregone insurance coverage now and the value of more oil later.

Response: Your proposal sounds like the status quo ante, exactly the position I am advocating. For two years, any contractor could look at the backwardation in the futures market, and make us an offer for deferral. We ran our own valuation of the delay, set a negotiating target for ourselves for a share of the money on the table, and if we hit our target we agreed to the deferral. Every contractor deferred deliveries; they understood the process, it mimicked what they do in the private sector, and no surprises. The status quo is what appears irrational to the market place. It leaves the contractor vulnerable to things such as a short squeeze in the Brent market, and in fact there have been some attempts to blame a recent squeeze in the dated Brent market on us for demanding delivery regardless of market circumstances. Also, remember Howard Borgstrom's thesis. It can be boiled down to, "If you decide to have a simple rule for acquiring SPR oil, the worst one you could possibly pick would be filling at a constant rate of speed."

- If a case is to be made that under certain normal market conditions filling the SPR will adversely affect the market, care should be taken to also identify the conditions under which filling the SPR would not effect the market, or may even be thought to have a beneficial effect on the market. Otherwise, the analysis will serve to make it much harder to fill the reserve later and achieve the desired SPR size in a timely fashion. Even if adverse and beneficial fill conditions are identified, justifying fill deferral on the basis of its market effects will sharply increase the "burden of proof" for filling the reserve. It will also increase the information requirement, since the DOE must estimate not only the (uncertain) costs of filling in the near future, but also how those costs will vary over time, given uncertainty about future market conditions.

Response: I agree in principle, however, the essence or my argument is the Government should reserve the flexibility to look at the markets and the economic conditions. You will never be able to catalogue all the scenarios. The only rule I am sure of is the futures market must be in backwardation.

- If the deferral option is to be pursued, we can anticipate the following critique: "If the government is interested in market order, under normal market conditions that interest may be better served by an orderly participation in the market, rather than strategically ducking in and out of the market." In an analogy to the Federal Reserve, there are strong reasons to avoid trying to anticipate and stabilize the market by making frequent or significant changes in SPR fill schedules. For this reason it seems that a steady-hand policy that allows market actors some flexibility in fill deliveries, but only gradually changes the terms under which that flexibility is offered, may be both advisable and most acceptable to the economic leadership in this administration.

Response: This is a reasonable argument. The SPR business model was to always wait for the contractor to approach the Government with an offer. The SPR Office would never make the

proposal for deferral to the contractor. The limiting factor is the desire of the contractor to negotiate; the more lucrative the deferral, the more volume will be deferred.

In a bit of role reversal, I am confidant the volume of oil we would put in play is not so great that if we deferred it all the markets would not be shaken to their foundations.

Proposed Framing of Issue: Deferral For Mutual Benefit of Industry and Government

- The DOE/SPR's may wish to take the position that deferral of SPR refill may be appropriate out of consideration for the cost and inconvenience to private agents in the oil market who must supply the oil, but NOT necessarily out of consideration for some possible large effect on the market price and a possible attendant social cost. Thus the DOE/SPR position could reasonably be that the effects of filling the SPR in this tighter market are principally a "transfer," imposing a greater cost on those who must supply the oil, but not markedly affecting market outcomes.

Response: If we were in the status quo ante position I would be satisfied with this argument. Now that the status quo is a fill model that was discredited years ago, I am inclined to use sexier arguments if they are sound directionally even though I may not be able to know their potency.

- This position has two benefits. (1) It does not require an estimate of large social costs from filling, which may well be unjustified and, if in error, could come back to haunt and paralyze the SPR, and (2) it emphasizes that deferral will benefit those who owe oil, so the DOE/SPR might fairly propose that the deferred deliveries should be slightly larger. If instead we were to estimate substantial *social* costs to filling now, the private agents could fairly suggest that perhaps they should be allowed to deliver *less* oil later in exchange for agreeing to the deferral!

Response: Ah, but what would be the legal foundation? The whole transaction is premised on the legal authority to exchange oil in order to acquire oil. Exchanging oil now for less oil later would at best be called an unauthorized oil sale or at worst an unauthorized sale in tandem with a money losing purchase. It would certainly fly in the face of the admonition in the law to minimize the cost of the acquisition.

Call if you want to discuss this, or I welcome any written material.

Regards,

May 28, 2002

John Shages
Office of Strategic Petroleum Reserves,
U.S. DOE

Dear John,

Economic Impacts of Filling and Deferred Filling of the SPR

I understand that you are interested in analyzing the social costs of filling the SPR, or the social benefits of delaying filling, and thereby exploring the merits of delaying fill *and* potentially building a case for private firms to swap back even more oil after delaying. Thank you for the opportunity to consider this timely issue, and to offer some suggestions on analytical approaches. While the general proposal for flexibility in fill delivery is appealing, I also suggest, respectfully, that there are significant risks from acting too hastily or on the basis of too casual an analytical approach. This note mentions some of these possible risks, and offers some analytic approaches which might suit the needs of the SPR Office while avoiding some of the potential pitfalls.

My principal purpose in this note is to raise some issues that you might not yet have had a chance to consider, and perhaps just repeat some points that we are all quite familiar with. I am still working through these issues myself, and appreciate the chance to get some of these thoughts on the table. I would be happy to discuss any of these points further.

This Mini-Study Proposes to Change the Terms of Debate on the SPR

- It has long been the DOE/SPR position that filling the SPR has small-to-no social effects or costs (beyond the direct costs), because
  - The proposed fill rates are all small compared to the amounts of excess oil capacity in the market, and the response of the market to such a small disturbance is ambiguous; and
  - The macro-economic dislocation associated with a small (less than $1/bbl) price change under normal, smoothly function markets with full anticipation of a pre-announced and steady fill rate, would surely be small, and certainly be undetectable with any possible empirical method.

Need to Recognize Distinction Between Effects of Filling and Drawing-down SPR

- Evaluating fill effects with essentially the same framework we use to evaluate drawdown benefits (i.e., estimating oil price changes with a very low short-run market price elasticity and then applying the elasticity of GDP with respect to oil price) would be likely to significantly overestimate the price effect, and would lead to a completely unreliable and highly exaggerated estimate of GDP effects.
- It is *very* important to distinguish qualitatively between the expected economic effects of SPR drawdown and SPR filling. The economic effects of a drawdown during a disruption derive from anticipated changes in market price of oil, and the possible macroeconomic consequences of those price changes. During an oil supply emergency, price changes can be large and unexpected. An SPR drawdown could add as much as 5% to world oil supply, significantly buffering the oil price shock.
- In contrast to drawdown, when filling the SPR price changes are likely to be modest, gradual, and sustained. Filling the SPR alters oil balances by 0.1% to 0.2% (for a 75 to 150 MMB fill rate). Under normal market conditions, the price effect of a SPR fill is ordinarily small and ambiguous, given that supply and demand are functioning smoothly, have many months to respond, and there is substantial excess capacity.

- Moreover, we can be confident that even if a limited oil price increase occurs, a price impact of that level is very unlikely to result in macroeconomic dislocation, or measurable GDP losses of any kind. The macro-economic dislocation associated with a small price change under normal, smoothly function markets with full anticipation of a pre-announced and steady fill rate, would surely be small, and certainly be undetectable with any possible empirical method. Note that the most recent empirical analysis of the oil-macro link emphasize that the dislocation seems to follow from price excursions that are outside the recent price range or norm. From 1990 to 2001, the average refiners acquisition cost of imported crude has had a monthly standard deviation of $4.65. Thus, even if the SPR fill would raise prices by $1, this would only be a "shock" of less than 1/4th of a standard deviation, far too small to disrupt firms, consumers, or investors.
- The recognition that SPR fill effects differ not only in degree but in *nature* from draw effects is critical to the argument for a government emergency reserve. If the costs of SPR fill are believed to be symmetric to the benefits of SPR draw, but simply smaller in magnitude in direct proportion to the magnitude of the associated oil flow, then filling the SPR could never be worthwhile. The cumulative costs of a gradual SPR fill would counterbalance any possible benefits from drawdown. In fact, costs would outweigh the benefits since drawdown benefits are doubly-reduced by probability-weighting and discounting, since they are uncertain and delayed by years. The expectation that the SPR can be filled slowly with little-to-no effect on market price, and insignificant macroeconomic spillover costs, is central to the conclusion that stockpiling can yield a positive expected net present value.

Alternative Approach to Deferral Analysis: Rely on Private Responses to the Market, and Focus on the Social "Insurance" Implications of Deferral

- It may be helpful to couch the planned analysis in terms of the social effects of *fill deferral* rather than the social effects of *filling* the SPR. The social costs of deferral stem largely from the temporary reduction or delay in the protection afforded by the SPR. The social benefits of deferral stem from the prospects for slightly larger deliveries of oil to the reserve by private firms later, in exchange for the right to defer. Simple estimates of the cost of delaying protection from delaying fill, and the benefits of added protection by filling more later, can be constructed from the existing size study cases.
- It is reasonable to posit that in the matter of fill planning the government's, and society's, principal interest resides in the weighing of these considerations regarding the timing and magnitude of SPR "insurance" coverage.
- In the absence of a clear indication that fill deferral is needed to avoid an adverse impact on the market, deferral considerations having to do with a detailed assessment of market conditions, current and prospective private inventory levels and/or futures spreads, and the fine tuning of delivery schedules on the basis of anticipated market conditions, are arguably best left to the private sector. Thus, one approach the SPR Office could take is to leave it to private sector firms to perform the market analyses they need to determine whether they wish to request fill deferral, while the government could establish the terms for a fill deferral based on its estimate of the tradeoff between foregone insurance coverage now and the value of more oil later.
- If a case is to be made that under certain normal market conditions filling the SPR will adversely affect the market, care should be taken to also identify the conditions under which filling the SPR would not effect the market, or may even be thought to have a beneficial effect on the market. Otherwise, the analysis will serve to make it much harder to fill the reserve later and achieve the desired SPR size in a timely fashion. Even if adverse and beneficial fill conditions are identified, justifying fill deferral on the basis of its market effects will sharply increase the "burden of proof" for filling the reserve. It will also increase the information requirement, since the DOE must estimate not only the (uncertain) costs of filling in the near future, but also how those costs will vary over time, given uncertainty about future market conditions

- If the deferral option is to be pursued, we can anticipate the following critique: "If the government is interested in market order, under normal market conditions that interest may be better served by an orderly participation in the market, rather than strategically ducking in and out of the market." In an analogy to the Federal Reserve, there are strong reasons to avoid trying to anticipate and stabilize the market by making frequent or significant changes in SPR fill schedules. For this reason it seems that a steady-hand policy that allows market actors some flexibility in fill deliveries, but only gradually changes the terms under which that flexibility is offered, may be both advisable and most acceptable to the economic leadership in this administration.

Proposed Framing of Issue: Deferral For Mutual Benefit of Industry and Government

- The DOE/SPR's may wish to take the position that deferral of SPR refill may be appropriate out of consideration for the cost and inconvenience to private agents in the oil market who must supply the oil, but NOT necessarily out of consideration for some possible large effect on the market price and a possible attendant social cost. Thus the DOE/SPR position could reasonably be that the effects of filling the SPR in this tighter market are principally a "transfer," imposing a greater cost on those who must supply the oil, but not markedly affecting market outcomes.
- This position has two benefits. (1) It does not require an estimate of large social costs from filling, which may well be unjustified and, if in error, could come back to haunt and paralyze the SPR, and (2) it emphasizes that deferral will benefit those who owe oil, so the DOE/SPR might fairly propose that the deferred deliveries should be slightly larger. If instead we were to estimate substantial *social* costs to filling now, the private agents could fairly suggest that perhaps they should be allowed to deliver *less* oil later in exchange for agreeing to the deferral!

I and my colleagues at ORNL would be glad to work with the SPR Office (at HQ or in New Orleans, as needed) on these issues. I also look forward to discussing any of these points with you at your convenience.

Best Regards,

Paul Leiby

EXHIBIT V-11

Hunt, Edith

From: Kateiva, George
Sent: Friday, October 11, 2002 6:09 AM
To: DMCOL
Subject: FW: October Forties & Mars

FYI
-----Original Message-----
From: Waggoner, Michael
Sent: Thursday, October 10, 2002 3:33 PM
To: 'DHPears@MAPLLC.com'
Cc: Callahan, David; Marland, Nancy (HQ); Kateiva, George; Habbaz, Roy; Gaillard, Rose
Subject: FW: October Forties & Mars Delivery

Following up my previous email the SPR is not considering deferrals at the time.

-----Original Message-----
From: Waggoner, Michael
Sent: Monday, October 07, 2002 8:49 AM
To: 'Pears, Daniel H.'
Cc: Callahan, David; Marland, Nancy (HQ); Kateiva, George; Habbaz, Roy; Gaillard, Rose
Subject: RE: October Forties & Mars Delivery

Dan, Forties is acceptable with no price differential. Still working your request on deferral.

-----Original Message-----
From: Pears, Daniel H. [mailto:DHPears@MAPLLC.com]
Sent: Wednesday, October 02, 2002 1:24 PM
To: Waggoner, Michael
Subject: October Forties & Mars Delivery

Mike,
As a follow up to our earlier conversations, Marathon Ashland would like to propose that North Sea Forties crude oil be added to the basket of crudes acceptable for delivery under our West Hackberry Sweet Crude exchange contracts. Specifically, we are seeking approval to deliver approximately 1,000,000 barrels of Forties to the SPR for the payback that is currently scheduled to be delivered into Sun Nederland in the October 23-28, 2002 window.

We are also interested in seeking approval to defer all, or a portion of the delivery of Mars sour crude oil that has been scheduled for October delivery to Bayou Choctaw through the Sugarland terminal. Our 250 MBD Garyville, LA refinery managed to maintain its run rate through Tropical Storm Isadore, but has depleted nearly all of its crude oil working inventory as receipts have been adversely impacted by the earlier shutdowns of the Gulf of Mexico pipeline systems. We did, however, have to make significant run cuts at our refineries located in Catlettsburg, KY and Canton, OH due to the lack of Gulf Coast receipts. With Hurricane Lili bearing down on us, and further supply disruptions the result, we will likely be forced to slowdown, or potentially shutdown, Garyville and the two northern plants due to lack of crude oil. We therefore request that we be allowed to defer the scheduled October Mars delivery in hopes that we can prolong or at least expedite the recommencement of refining operations at those facilities.

Wishing you a safe week,
Dan Pears
Mgr. International Crude Supply & Trading
Marathon Ashland Petroleum LLC
Houston, TX
(713) 296-2417



EXHIBIT V-12

FOR IMMEDIATE RELEASE
January 24, 2003

Contact: Tara Andringa 202-228-3685
Tara_Andringa@levin.senate.gov

Levin Calls on Bush Administration To Suspend SPR Oil Shipments to Prevent New Oil Price Surge

WASHINGTON – As crude oil prices near a 10-year high and the U.S. Department of Energy (DOE) plans for delivery of some of the largest crude oil shipments to the U.S. Strategic Petroleum Reserve (SPR) in years, Sen. Carl Levin, D-Mich., **today called on the Bush Administration to suspend further SPR deposits until surging crude oil prices stabilize and consumers get relief from rising prices for gasoline, home heating oil, and other petroleum products.**

"This is not the time to be putting oil into the Reserve; it will reduce world oil supplies, drive crude oil prices higher, and hurt American consumers and business," said Levin. "Crude oil prices are already approaching heights not seen since the Gulf War. The coldest U.S. winter in 10 years has boosted demand for oil, while a production cutback by one of our major suppliers, Venezuela, has reduced U.S. crude oil imports. U.S. crude oil stocks are now at their lowest point ever. If the order goes out to fill the Reserve now, we will be taking millions of barrels of crude oil off the marketplace at a time when there isn't enough to meet demand. We will disrupt crude oil markets even more and push prices even higher."

Current contracts to fill the SPR call for depositing 4.4 million barrels of crude oil in March and another 3.7 million barrels in April. To meet these delivery schedules, oil companies are now purchasing the crude oil and chartering crude oil tankers to deliver it.

Some SPR deliveries scheduled for last December 2002, or for January or February 2003, have been deferred by DOE, but deliveries for March and April have not been deferred.

"In the past, oil companies delivering crude oil to the SPR have delayed deliveries in the face of spiking oil prices, and DOE ought to talk to them about a delay now," said Levin. "If delayed deliveries aren't possible, DOE could calm markets by immediately releasing any delivered oil onto the marketplace."

In November 2001, President George W. Bush ordered the SPR to be filled to its maximum capacity of 700 million barrels as quickly as possible. The SPR now holds 600 million barrels of crude oil, the largest volume in its history.

"Rising crude oil prices damage the U.S. economy by increasing the cost of gasoline and oil for consumers and increasing operating costs for business," said Levin. "American consumers and business have already been paying a crude oil 'war premium' of at least a $5 a barrel for months. Reducing crude oil supplies by filling the SPR now would raise prices again and strike another blow to the U.S. economy."

The SPR was first established in the 1970s. Its primary mission is to provide a source of crude oil to meet U.S. needs in the event of a severe disruption in supply. President George H.W. Bush ordered the first release of oil from the SPR at the outset of the Gulf War in 1991. About 17 million barrels were released. In 2000, President Clinton ordered a second SPR release to counter rising prices for home heating oil. About 30 million barrels were released. Both times, oil prices dropped, as shown in the attached chart tracking crude oil prices since 1990.

"The two times oil was released from the SPR, crude oil cost about $32 a barrel and the President acted because the price was high," Levin explained. "Today the cost is $34 a barrel, but the course the government is on is to send more oil to the SPR, reduce world supplies, and spike prices even higher. **The Administration should be putting oil in the Reserve when market prices are low, not high. Removing oil from the marketplace now would send hundreds of millions of dollars into the pockets of oil companies and oil-producing countries at the expense of American consumers and business forced to pay the higher prices that will result."**

The amount of crude oil held in U.S. storage is at a ten-year low, as shown in the attached chart tracking U.S. oil inventories. Last week, DOE's Energy Information Administration (EIA) warned that continued reductions in U.S. crude oil inventories could force U.S. oil refiners to cut back production, causing energy prices to skyrocket. According to the EIA, "So while all of the dominoes haven't fallen yet, unless additional crude oil supply arrives in the near future, we could be watching the dominoes topple each other over the next month or two."

"U.S. crude oil stocks are dangerously low," said Levin. "We are standing on a cliff. If stocks go any lower, even a minor problem could disrupt supplies, shut down refineries, and spike gasoline and oil prices, inflicting more pain on U.S. consumers."

In 2002, as Chairman of the Senate Permanent Subcommittee on Investigations, Levin initiated an investigation into the extent to which the Administration's program to fill the SPR may be affecting crude oil prices. A report

summarizing the results of that investigation is being prepared and is scheduled to be released in a few weeks.

"American consumers and businesses already are paying the oil companies and oil-producing countries a premium for basic necessities -- to drive our cars, heat our homes, and ship our goods," said Levin. "The last thing the American people need right now is for its government to take oil off the market and send oil prices even higher."

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