DESCRIPTION OF REVENUE-RELATED PROVISIONS
OF H.R. 776
("COMPREHENSIVE NATIONAL ENERGY POLICY ACT")

Scheduled for a Hearing

before the

HOUSE COMMITTEE ON WAYS AND MEANS

on April 28, 1992

Prepared by the Staff

of the

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INTRODUCTION

The House Committee on Ways and Means has scheduled a public hearing on April 28, 1992, on the revenue-related provisions of H.R. 776 ("Comprehensive National Energy Policy Act"), as reported by the House Committee on Energy and Commerce on March 30, 1992. The revenue-related provisions of the bill as reported (sec. 732, and Titles X, XI, and XIV) have been sequentially referred to the Committee on Ways and Means for a period ending May 1, 1992.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the revenue-related provisions of H.R. 776. Part I of the document is a legislative background on H.R. 776. Part II is a summary of the revenue-related provisions of the bill. Part III is a description of the revenue-related provisions of the bill as reported by the Committee on Energy and Commerce, including present-law rules and issues related to the provisions referred to the Committee on Ways and Means. Part III also includes a description of a provision relating to extension of the coal reclamation fee as ordered reported by the House Committee on Interior and Insular Affairs on April 8, 1992.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Revenue-Related Provisions of H.R. 776 ("Comprehensive National Energy Policy Act") (JCX-15-92), April 27, 1992.

I. LEGISLATIVE BACKGROUND

H.R. 776 ("Comprehensive National Energy Policy Act") was reported by the House Committee on Energy and Commerce on March 30, 1992 (H. Rept. 102-474, Part 1). Revenue-related provisions of the bill (sec. 732, and Titles X, XI, and XIV) were sequentially referred to the Committee on Ways and Means for a period ending May 1, 1992.

Provisions of H.R. 776 were also referred to other committees through May 1, 1992, as follows: Committee on Foreign Affairs (Titles XII and XIII); Committee on Government Operations (Title III); Committee on the Judiciary (Titles VI and VII); Committee on Interior and Insular Affairs (Titles VIII, IX, X, XI, and XIX); Committee on Merchant Marine and Fisheries (Titles II, XVI, and XVII); Committee on Public Works and Transportation (Titles I, IV, and XVIII); and Committee on Science, Space, and Technology (Titles VI, IX, XII, and XIII).

On April 8, 1991, the Committee on Interior and Insular Affairs ordered reported H.R. 776 with amendments, including an extension of the coal reclamation fee.

II. SUMMARY OF PROVISIONS

Tax-Exempt Bond Financing of Facilities for Local Furnishing of Electricity or Gas (sec. 732 of the Bill)

H.R. 776 authorizes the Federal Energy Regulatory Commission ("FERC") to order electric utilities to provide wheeling services to independent power producers. These FERC orders also may require the utilities to enlarge their transmission systems to comply. If wheeling activities pursuant to these orders were conducted using bond-financed facilities, or if the utility (viewed in light of both its wheeling and other activities) became a net exporter of electricity, the present-law local furnishing exception for tax-exempt bond financing could be violated. To prevent such an occurrence, the bill modifies present law to provide that no disqualification will result from wheeling activities conducted pursuant to a FERC order authorized under the bill.

Uranium Enrichment Fund and Assessment (Titles X and XI of the Bill)

Title XI of H.R. 776 establishes a Uranium Enrichment Decontamination and Decommissioning Fund ("UEDD Fund"). Annual deposits of $500 million (indexed for inflation) are to be made into the UEDD Fund until such time as the balances in the UEDD Fund are sufficient to finance the decommissioning and decontamination of DOE's uranium enrichment facilities.

Annual deposits to the UEDD Fund generally will come from certain primary sources specified in the bill. In the event funding from these primary sources is insufficient to provide the annual mandated contribution to the UEDD Fund, however, the bill authorizes the Secretary of Energy to make a special assessment on the owners of certain domestic utilities to fund the required balance of the annual deposit. Utilities subject to the special assessment are those utilities who in the past have purchased fuel from the DOE. The rate of assessment is determined by dividing the remaining required balance of the annual deposit by the total purchase of separative work units (the service of enriching uranium) purchased by domestic utilities from the DOE prior to the date of enactment. The total tax liability of each utility is then computed as the amount of separative work units purchased from the DOE by a domestic utility multiplied by the rate of tax determined as described above.

Strategic Petroleum Reserve (Title XIV of the Bill)

Title XIV of H.R. 776 establishes a mechanism for

increasing the capacity of the nation's Strategic Petroleum Reserve ("Reserve") by requiring importers and purchasers of petroleum products to lend specified amounts of crude oil and other petroleum products to the Federal Government until the target quantity of the Reserve is reached. Under the bill, importers and purchasers are required to provide for the storage in the Reserve of an amount of petroleum product equal to a specified percentage of the amount of their crude oil or petroleum product. A person providing petroleum product to the Reserve as a result of the bill's requirements retains and may freely transfer title to the product stored in the Reserve. An importer or purchaser may elect to provide, in lieu of petroleum product, an amount equal to the cash equivalent of the amount of petroleum product required to be stored by it in the Reserve. The bill also authorizes the Energy Department to assess and collect storage charges, beginning in the 1993 fiscal year, from each importer and purchaser who has petroleum product stored in the Reserve.

When the petroleum product stored in the Reserve under the bill is sold as a result of a drawdown on the Reserve, the Energy Department is required to provide for the payment of the amount received for the sale to the importer or purchaser, or to such person's assignee, who held title to the petroleum product that was sold. In carrying out this requirement, the Energy Department will consider the first amount of petroleum product withdrawn from the Reserve to be the petroleum product stored in the Reserve under this provision of the bill (to the extent thereof). The Energy Department also must provide for the payments to importers and purchasers to be made on the basis of the order in which such persons provided for the storage of petroleum product in the Reserve.

Abandoned Mine Reclamation Fund

The bill as reported by the Committee on Interior and Insular Affairs extends the coal reclamation fee through September 30, 2010, and provides that $50 million of the amounts in the coal reclamation fund in each fiscal year be deposited in a new "Coal Industry Retiree Benefit Fund" (not yet established).

III. DESCRIPTION OF PROVISIONS

A. Tax-Exempt Bond Financing of Facilities for Local Furnishing of Electricity or Gas (sec. 732 of the Bill)

Present Law

In general

Interest on State and local government bonds generally is excluded from income for purposes of the regular individual and corporate income taxes if the proceeds of the bonds are used to finance direct activities of these governmental units (Code sec. 103). Present law also excludes the interest on certain State and local government bonds ("private activity bonds") when a governmental unit incurs debt as a conduit to provide capital financing for private parties if the financed activities are specified in the Code. Tax-exempt private activity bonds may not be issued to finance activities not specified in the Code.

Private activity bonds are bonds (1) more than 10 percent of the proceeds of which satisfy a private business use and payment test, or (2) more than five percent ($5 million, if less) of the proceeds are used to finance loans to persons other than State or local governmental units. A special restriction reduces the private business use and payment limits to five percent in the case of private business activities that are unrelated to direct governmental activities also being financed with a bond issue.

Interest on the following private activity bonds qualifies for the above-mentioned exclusions from income:

(1) Exempt-facility bonds;
(2) Qualified mortgage and qualified veterans' mortgage bonds;
(3) Qualified small-issue bonds;
(4) Qualified student loan bonds;
(5) Qualified redevelopment bonds; and
(6) Qualified 501(c)(3) bonds.

Exempt-facility bonds are bonds the proceeds of which are used to finance the following: airports, docks and wharves, mass commuting facilities or high-speed intercity rail facilities; water, sewage, solid waste, or hazardous waste disposal facilities; facilities for the local furnishing of electricity or gas; local district heating or cooling facilities; and certain low-income rental housing projects.

__Exempt-facility bonds for the local furnishing of electricity or gas__

The exempt-facility bond exception for facilities for the local furnishing of electricity or gas is limited to bonds used by electric or gas systems the service area of which does not exceed either (1) two contiguous counties or (2) a city and a contiguous county.[2] Property eligible for financing under the exception includes depreciable property and land used to "produce, collect, generate, transmit, store, distribute, or convey electric energy" in a qualified service area. (Treas. reg. sec. 1.103-8(f)(2)(iii).)

The local furnishing exception does not apply to facilities that are an integral part of the regional supplying of electricity, e.g., long-line transmission. (See, H. Rept. 90-1533, 90th Cong., 2d Sess., at 38.) The Treasury Department's regulations interpreting this exception provide, however, that an otherwise qualifying facility will not be ineligible solely because the system of which it is a part is interconnected with other utility systems for the emergency transfer of power.

Further, the Internal Revenue Service ("IRS"), in a series of ruling letters, has provided specific, nonprecedential guidance to several utilities regarding the extent to which nonemergency interconnections with other utility systems are permitted. (See, e.g., Ltrs. 8915021, 8508051, and 8319017 (supplemented by Ltrs. 8322009 and 8429091).) These ruling letters make three significant factual points regarding the extent to which local furnishing utilities may be interconnected with other utilities.

First, each of these ruling letters specified that, despite limited outbound electricity transfers, the systems involved, even after taking into account any wheeling activities, were net importers of electricity. Second, in Ltr. 8915021, certain transmission activities for the benefit of other utilities ("wheeling") on dedicated facilities were held not to disqualify a local furnishing system because the cost of the facilities used were borne by the recipient of the wheeled electricity, not the local furnishing utility or its ratepayers. Third, in holding that certain incidental interconnections not involving dedicated facilities such as those described in Ltr. 8915021 did not violate the local

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[2] Section 644 of the Tax Reform Act of 1984 (P. L. 98-369) expanded the exception further to include the Long Island Lighting Company and the Bradley Lake hydroelectric facility system in Alaska, based on activities engaged in by those systems as of the date of that Act's enactment.

furnishing requirement, the IRS stressed that the facilities "have not been designed differently, sized larger, built sooner, or constructed in a more costly fashion that is reasonably required solely for serving" the local furnishing service area. (See, Ltr. 8319017.)

Explanation of Provision

As reported by the Committee on Energy and Commerce, H.R. 776 authorizes the Federal Energy Regulatory Commission ("FERC") to order electric utilities (including those qualifying under the local furnishing exception) to provide wheeling services to independent power producers. These FERC orders also may require the utilities to enlarge their transmission systems to comply. If wheeling activities pursuant to these orders were conducted using bond-financed facilities, or if the utility (viewed in light of both its wheeling and other activities) became a net exporter of electricity, the local furnishing exception could be violated. To prevent such an occurrence, the bill modifies present law to provide that no disqualification will result from wheeling activities conducted pursuant to a FERC order authorized under the bill.

Issues

Tax-exempt bond financing provides a Federal subsidy to certain gas and electric utilities. Two classes of these utilities may utilize tax-exempt financing for their facilities: municipally-owned gas and electric utilities and privately-owned gas and electricity utilities that satisfy the "local furnishing" standard. The presumed original intent of the so-called "local furnishing exception" was to permit below-market financing for those utilities whose operations are constrained to smaller geographic areas and that, in certain cases, may not be able to access national capital markets. In addition, the local furnishing exception may also allow qualifying utilities to operate with a similar cost structure to comparable municipally-owned utilities in nearby jurisdictions.

The bill's provision affecting the local furnishing exception states that a utility will not be disqualified from the exception due to wheeling activities undertaken pursuant to FERC orders. This provision will protect the status of utilities currently qualifying for the local furnishing exception from possible disqualification due to wheeling activities in response to FERC orders. However, the provision may also provide certain utilities with the incentive to engage in relatively large amounts of wheeling activities, for which the utility receives a fee.

The operation of non-utility independent power producers (IPPs) in particular local areas could result in the

generation of much more electricity than can be used by customers in the local market. Federal energy policy generally has been favorable to IPPs, causing them to become increasingly important providers of electricity. The bill recognizes the increased prominence of IPPs in many areas through the provision permitting FERC orders to utilities for the provision of wheeling services. This would permit IPPs to generate electricity for ultimate sale to customers far outside the local area where the generation occurs.

Conversely, permitting "local furnishing" utilities to continue tax-exempt bond financing while undertaking extensive wheeling activities extends the local furnishing exception to utilities that are essentially a part of a regional power system. To the extent this occurs, the policy justification for the local furnishing exception is obscured.

B. Uranium Enrichment Fund and Assessment (Titles X and XI of the Bill)

Background and Present Law

Uranium mining and enrichment

Uranium (U_{235}) is the fuel used in commercial and military nuclear reactors. Uranium ore has insufficient amounts of U_{235} to be useful to commercial or military nuclear reactors. To create nuclear fuel, the amounts of U_{235} must be concentrated; that is, the uranium must be enriched. At present, enriched uranium used by western countries comes from four sources: the U.S. Department of Energy ("DOE"); Eurodif (a consortium established by the French, Italian, Spanish and Belgian governments); Eurenco (a consortium established by the British, Dutch, and West German governments); and the former Soviet Union. No private firms enrich uranium. Users of uranium fuel generally provide the uranium to be enriched. The users generally are charged for the process of enriching in terms of "separative work units."

Congress makes annual appropriations to DOE to fund construction, operation, and research activities related to uranium enrichment. DOE has uranium enrichment facilities in Oak Ridge, Tennessee; Paducah, Kentucky; and Portsmouth, Ohio. These facilities only enrich uranium for commercial and military nuclear reactors. DOE operates separate facilities to produce weapons-grade plutonium. The facility in Oak Ridge currently is out of production due to insufficient demand, and is in the process of being decommissioned. Construction was begun on a gas centrifuge enrichment plant next to the existing plant in Portsmouth, but it was not completed.

Prior to the 1950s, the United States imported most of its uranium ore from abroad. To spur domestic mining, the Atomic Energy Commission ("AEC") instituted a program of purchase and price guarantees and bonuses. In 1967, the AEC stopped buying foreign uranium. In 1970, having built up a sufficiently large stockpile, the AEC stopped buying uranium altogether. The Atomic Energy Act permits DOE to impose import restrictions if they are necessary to ensure the viability of the domestic uranium industry. The Atomic Energy Act does not specifically permit charges on foreign uranium.

Prior to 1964, all enriched nuclear material in the United States was owned by the Federal Government. In 1964, Congress amended the Atomic Energy Act to permit private ownership of enriched uranium for foreign and domestic utilities. DOE enriches foreign uranium for both domestic and foreign utilities. DOE currently produces approximately

50 percent of the enriched uranium used by western countries.

Uranium mill tailings

Uranium mill tailings are the wastes remaining after uranium has been extracted from uranium ore. Mill tailings contain low concentrations of naturally occurring radioactive materials and emit radon gas.

In 1978, Congress enacted the Uranium Mill Tailings Radiation Control Act. That law requires that the mill tailings at 24 designated inactive sites[3] be cleaned up by DOE with the Federal Government paying 90 percent of the cost and the State where the site is located paying the remainder.

Present law makes the cleanup of active sites the responsibility of the site owner. The Nuclear Regulatory Commission and the Environmental Protection Agency are to develop regulations to provide for the reclamation of these sites. Posting of a bond to ensure that the operator will have adequate resources to clean up each site is a requirement to obtain an operator's license.[4]

Tax-related aspects

Under special tax rules (Internal Revenue Code secs. 468 and 468A), certain costs of coal mine and waste disposal site reclamation and nuclear power plant decommissioning may be deducted prior to the time that the reclamation or decommissioning work is performed. These provisions are an exception to the general rule which prohibits the accrual of an expense prior to the time economic performance occurs (sec. 461(h)).

A taxpayer that is required to decommission a nuclear power plant may elect to deduct certain contributions that are made to a nuclear decommissioning fund. A nuclear decommissioning fund is a segregated fund the assets of which are to be used exclusively to pay nuclear decommissioning costs, taxes on fund income, and certain administrative costs. The assets of a nuclear decommissioning fund that are not currently required for these purposes must be invested in (1) public debt securities of the United States, (2) obligations of a State or local government that are not in

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[3] These sites were defined in the Act and were no longer producing uranium at the time of enactment.

[4] In 1981, in an amendment to the national security and military applications provisions of the Nuclear Energy Authorization Act, Congress expressed an interest in assisting in the reclamation of active sites.

default as to principal or interest, or (3) time or demand deposits in a bank or an insured credit union located in the United States. These investment restrictions are the same restrictions which apply to black lung trusts that are established under Code section 501(c)(21).

Owners of coal mines are assessed a fee to help pay for the reclamation of abandoned mines. These fees provide the amounts available for appropriation from the Abandoned Mine Reclamation Fund. The current rates are 35 cents per ton for surface mined coal and 15 cents per ton for underground mined coal. These fees are scheduled to expire after September 30, 1995.

Under present law, four different Superfund taxes are imposed: (1) a tax on petroleum; (2) a tax on listed hazardous chemicals; (3) a tax on imported substances that contain or use chemical derivatives of one or more of the specified hazardous chemicals; and (4) an environmental tax based on the amount of modified alternative minimum taxable income of a corporation that exceeds $2 million. The receipts from these taxes are deposited in the Hazardous Substance Superfund. Amounts in this trust fund generally are available for expenditures incurred in connection with releases or threats of releases of hazardous substances into the environment.

Under present law, there is no general Federal excise tax or user fee imposed on the generation or sale of electricity. However, to support the Nuclear Waste Fund, there is a specific fee of 0.1 cent per kilowatt hour (kwh) imposed by the Nuclear Waste Policy Act of 1982 on generation of electricity from nuclear power.

The Nuclear Regulatory Commission currently assesses other fees on the owners of nuclear power plants. Operators of nuclear power plants are charged fees based upon the number of staff hours required to inspect the facilities. The fees recover the costs incurred in inspecting the facilities, but do not recover all of the costs involved in regulating nuclear power plants.

Explanation of Provisions

Uranium enrichment fund

Title XI of H.R. 776 as reported by the Committee on Energy and Commerce establishes a new trust fund in the Treasury, the Uranium Enrichment Decontamination and Decommissioning Fund ("UEDD Fund"). Annual deposits of $500 million are to be made into the UEDD Fund until such time as the balances in the UEDD Fund are sufficient to finance the decommissioning and decontamination of DOE's uranium enrichment facilities. The annual $500 million contribution

is to be indexed for future inflation, by an index to be determined by the Energy Secretary.[5]

Financing of the uranium enrichment fund

The source of annual deposits to the UEDD Fund generally will come from certain primary sources specified under the bill. Included among those primary sources are funds received by the Treasury as proceeds from the leasing of gaseous diffusion uranium enrichment facilities and related property, royalty payments from licensing atomic vapor laser isotope separation technology (AVLIS), contributions to the Fund by foreign utilities that purchase enriched uranium from the Energy Department, or by their governments, and interest earnings and proceeds from the disposition of debt instruments held by the Fund. However, in the event that funding from these primary sources are insufficient to provide the annual mandated contribution to the UEDD Fund, the bill authorizes the Energy Secretary to make a special assessment on the owners of certain domestic utilities to fund the required balance of the annual deposit. Owners subject to the special assessment are those owners who in the past have purchased fuel from the DOE.[6]

The rate of assessment is to be determined by dividing the remaining required balance of the annual deposit by the total purchase of separative work units (the service of enriching uranium) purchased by domestic utilities from the DOE prior to the date of enactment. The total tax assessment of each utility is then computed as the amount of separative work units purchased from the DOE in the past by a domestic utility multiplied by the rate of assessment determined as described above.

The bill also directs the Energy Secretary to periodically review and determine the adequacy of revenue for the UEDD Fund and alter collections of the special assessment.

Issues

As a result of the presence of radon gas and other radioactive materials, uranium mill tailings present a

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[5] The bill (Title X) provides for separate use of assets in the UEDD Fund to cover costs of decontamination, decommissioning, and reclamation of active uranium and thorium processing sites.

[6] The special assessment applies to the past purchases of public power corporations or authorities as well as to the purchases by investor-owned utilities.

potential threat to the environment and public health. Similarly, the radioactive materials used to make enriched uranium fuel present a potential threat to the environment and public health. Controlling these hazards through reclamation and decontamination imposes costs on society. Present law generally requires that the mining companies bear these costs in the case of mine tailings (an exception is the 24 inactive mining sites designated for governmental clean-up by the Uranium Mill Tailings Radiation Control Act of 1978). H.R. 776 would cause the Federal Government directly to assume some of the clean-up costs in the case of mine tailings and require that utilities maintaining nuclear facilities (through the special assessment) and the Federal Government (through other payments into the UEDD Fund) share those costs which relate to the decontamination and decommissioning of the DOE's uranium enrichment facilities.

Under present law, the liability of the relevant mining companies for future reclamation of mine tailings is perceived as a cost of the mining business and is recovered in the price charged for uranium ore. In this way, utilities and the Federal Government ultimately share in the cost of reclamation to the extent that they consume uranium. However, entities with no economic connection to the uranium industry may bear none of these costs. Increased Federal involvement in reclamation of mine tailings could lower the cost to non-federal users of domestically mined uranium by shifting some of the cost burden directly to the Federal Government. On the other hand, the other funding sources of the UEDD Fund may result in higher costs to the DOE in providing enriched uranium for nuclear reactors, thereby increasing the costs of uranium to domestic utilities. To the extent the uranium industry is competitive, whatever changes there may be in costs probably would be reflected in the price the Federal Government and utilities would pay for uranium. Most regulatory authorities permit utilities to pass through increased fuel costs to the ultimate consumer. If the creation and funding of the UEDD Fund results in higher prices of nuclear fuel, it might result in higher electricity costs for both individuals and businesses.

The special assessment which would be imposed by H.R. 776 is equivalent to an excise tax on the purchase of enriched uranium fuel. However, this tax would be assessed upon past, rather than current, purchases of uranium. As such, it does not affect the current operating costs of domestic utilities. In an unregulated and perfectly competitive market, such a tax could not be passed on to consumers or employees, but would rather be borne by the owners of the utility as a form of windfall loss. However, generation of electricity occurs in a non-competitive and regulated market. Regulators may permit the tax to be passed on to consumers as a fuel cost, or as an increased operating cost, as part of the regulatory process. If the assessment

were altered, under the authority granted to the Energy Secretary, to be imposed on current purchases, then as a cost of fuel at least part of the tax might be passed forward to consumers of electricity as part of fuel cost adjustment clauses which are common in the regulated electric utility market.

The proposed assessment would apply only to purchases of domestically enriched uranium. On the one hand, this may be appropriate because the cleanup costs to be funded by the UEDD Fund relate to domestic facilities. However, DOE has enriched uranium for foreign consumers in the past. It can be argued that part of the clean-up costs arise from enrichment activities for foreign use, but the bill only would tax domestic use. In addition, applying the tax only on the basis of domestic purchases may be perceived as treating more favorably those utilities that purchased their fuel in the past from foreign suppliers.[7]

To the extent that the tax is based only on past consumption and not current consumption, the relatively unfavorable treatment of domestic purchases should not affect the current or future choice of fuel supplier. However, if utilities perceive the tax to be an ongoing liability, an economic incentive may be created to purchase fuel from abroad. Increased demand for foreign nuclear fuel could have adverse effects on the domestic nuclear fuel industry.[8] Some may question the desirability of relying on foreign sources of supply.

As noted above, the bill authorizes the Energy Secretary to adjust collections of the special assessment to insure the adequacy of the revenue for the UEDD Fund. The bill does not specify whether the Secretary is to alter the base or the rate of the assessment. This lack of specificity may create undue uncertainty among taxpayers.

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[7] The bill is unclear as to how the special assessment would be calculated in the case of a utility which has declared bankruptcy and ceased operation subsequent to its purchase of uranium from DOE.

[8] Increased reliance on foreign suppliers also would have the effect of shifting future potential environmental and health damage abroad.

C. Strategic Petroleum Reserve (Title XIV of the Bill)

Present Law

There is no requirement under present law that specified persons lend certain amounts of their crude oil or other petroleum products to the Federal Government for the Strategic Petroleum Reserve.[9] In addition, there is no provision under present law which assesses specified persons for storage costs related to the Strategic Petroleum Reserve.

The Internal Revenue Code establishes an excise tax of 5 cents per barrel on domestic crude oil and imported petroleum products (including imported crude oil) for the purpose of funding the Oil Spill Liability Trust Fund. In addition, a 9.7 cents per barrel excise tax is imposed on domestic crude oil and imported petroleum products for the purpose of funding the Hazardous Substance Superfund. The excise taxes on domestic crude oil are imposed on the operator of any United States refinery receiving such crude oil, while the taxes on imported petroleum products are imposed on the person entering the product into the United States for consumption, use, or warehousing. If domestic crude oil is used in, or exported from, the United States before imposition of the taxes on the operator of a refinery, the taxes are imposed on the user or exporter of the oil.

Explanation of Provisions

In general

Title XIV of H.R. 776 as reported by Energy and Commerce establishes a mechanism for increasing the capacity of the nation's Strategic Petroleum Reserve (the "Reserve") by requiring certain persons to lend specified amounts of crude oil and other petroleum products to the Federal Government. The target capacity of the Reserve as set forth in the bill is the greater of one billion barrels of crude oil and refined petroleum product or the number of barrels equal to the net number of barrels of crude oil and refined petroleum product estimated by the Secretary of Energy to be imported

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[9] The Strategic Petroleum Reserve is a Federal Government-owned stockpile of oil stored in Louisiana and Texas. Its purpose is to provide a short-term supply of oil to protect American consumers against the shock to the economy resulting from crises such as the 1990 Iraqi invasion of Kuwait and subsequent oil embargo. (Report of the Committee on Energy and Commerce, H. Rept. No. 102-474, Part 1, 102d Cong., 2d Sess., at 148).

into the United States during an average 90-day period during the fiscal year concerned.[10] The Energy Department will request funds to cover the estimated costs of expanding the Reserve from the Appropriations Committees, and will carry out the petroleum product set-aside program only if money is appropriated for the Reserve.

Filling the Reserve

In general

The bill requires the Secretary of Energy to establish and implement, beginning March 31, 1993, a program in the manner provided in the bill for the filling of the Reserve at an average rate of 150,000 barrels of petroleum product per day during the portion of fiscal year 1993 in which the bill is in effect and during each fiscal year thereafter until the specified Reserve quantity is reached. During this period, any oil leased from foreign governments by the Federal Government, or obtained by any other means, and stored in the Reserve will be subtracted from the 150,000 barrel per day requirement. The bill provides that in establishing and implementing the set-aside program, the Energy Department will provide guidance specifying that the requirement for filling the Reserve shall be placed upon two categories of persons--importers of crude oil and petroleum products (herein referred to as "importers")[11] and persons who purchase crude oil or natural gas liquids produced domestically for purposes of refinement (herein referred to as "purchasers").

Under the bill, importers and purchasers are required to provide for the storage in the Reserve of an amount of petroleum product equal to a specified percentage of the amount of their crude oil or petroleum product. The specified percentage is to be determined periodically by the Energy Department as the percentage that would be sufficient, if applied uniformly to all importers and purchasers, to satisfy the fill rate for the Reserve as set forth in the bill.[12]

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[10] The present capacity of the Reserve is about 1 billion barrels. Oil currently stored in the Reserve is about 600 million barrels.

[11] The bill defines the term importer by reference to Part B of Title I of the Energy Policy and Conservation Act (42 U.S.C. 6231 et. seq.). That statute defines the term "importer" as any person who owns, at the first place of storage, any petroleum product imported into the United States (42 U.S.C. 6232(2)).

The bill grants the Energy Department the authority to provide that the petroleum product required to be stored in the Reserve under this provision of the bill be limited to grades of crude oil determined to be appropriate by the Secretary. The importer or purchaser may elect to provide, in lieu of petroleum product, an amount equal to the cash equivalent of the amount of petroleum product required to be stored by it in the Reserve.[13]

Beginning with fiscal year 1993 and continuing until the quantity of refined petroleum product in storage is 50 million barrels, the Energy Department will provide that 12 percent by volume of the petroleum product added to the Reserve during any fiscal year shall be refined petroleum product stored in a refined petroleum product reserve or reserves located in Petroleum Administration for Defense District 1A or 1B. The bill grants the Energy Department authority to provide that the refined petroleum product required to be stored in the Reserve be limited to refined petroleum product determined to be appropriate by the Secretary.[14]

Treatment of importers of petroleum products

In determining the amount of petroleum product to be contributed to the Reserve by an importer, the specified percentage is multiplied by the amount of its petroleum product which satisfies two requirements. First, the petroleum product must be entered into the United States for the purpose of consumption, use, or warehousing during the portion of any fiscal year for which the bill is effective. Second, the petroleum product must be owned by the importer at the first place of storage in the United States.[15]

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[12] According to the Report of the Committee on Energy and Commerce, the crude oil to be provided is equal, at current or projected consumption levels, to just less than one percent of the total annual volume of petroleum imported or the amount purchased to refine. (H. Rept. No. 102-474, Part 1, 102d Cong., 2d Sess., at 218.)

[13] Amounts of cash payments received in lieu of petroleum products are to be deposited in the U.S. Treasury in the "SPR Fill and Construction Fund" as established by the bill and may be obligated and expended by the Energy Department as provided under the bill.

[14] The Energy Secretary may provide for the acquisition by lease or purchase of refined petroleum product storage facilities using amounts in the SPR Fill and Construction Fund. The Secretary may not construct facilities for the storage of refined petroleum products.

Treatment of purchasers of petroleum products

In the case of a purchaser, the specified percentage is multiplied by the amount of domestically produced crude oil and natural gas liquids it purchases, during the portion of any fiscal year to which the bill applies, for purposes of refinement.[16] In this case, the bill only applies to initial purchases of such crude oil or natural gas liquids for purposes of refinement.[17]

Exception for exports

The bill provides certain exceptions for exported petroleum products to the Reserve set-aside requirement. Generally, these exceptions are realized through the granting of credits to such persons, which credits may be used to offset the persons' required contribution amounts.

Title to contributed petroleum products

Under the bill, a person providing petroleum product to the Reserve as a result of the bill's requirements retains title to such product stored in the Reserve. The bill specifies that such a person may freely transfer title to the stored petroleum product. In addition, the Energy Department is authorized to allow the title holder the use of such petroleum product as collateral in any financial transaction involving the title holder.

Effects of a drawdown on the Reserve

The bill provides that the stored petroleum product may not be withdrawn or distributed from the Reserve except as

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[15] In determining the amount of petroleum product that is to be provided for storage in the Reserve by an importer for any fiscal year, or portion thereof, the amount of petroleum product imported by such importer during the period of any drawdown and distribution of the Reserve occurring during such fiscal year is not taken into account.

[16] For purposes of this provision of the bill, the term "refinement" means the processing of crude oil or natural gas liquids, including the use of such crude oil or natural gas liquids as fuel, by a refinery or petrochemical plant.

[17] In determining the amount of petroleum product that is to be provided for storage in the Reserve by a purchaser for any fiscal year, or portion thereof, the amount of crude oil or natural gas liquids purchased by such purchaser during the period of any drawdown and distribution of the Reserve occurring during such fiscal year is not taken into account.

provided in section 161 of the Energy Policy and Conservation Act.[18] When the petroleum product stored in the Reserve under the bill is distributed as a result of a drawdown on the Reserve, the Energy Department is required to provide for the payment to each importer or purchaser, or to such person's assignee, of the amount received for the sale of the petroleum product stored in the Reserve as a result of actions taken by such importer or purchaser. In carrying out this requirement, the Energy Department will consider the first amount of petroleum product withdrawn from the Reserve to be the petroleum product stored in the Reserve under this provision of the bill (to the extent thereof). The Energy Department also must provide for the payments to importers and purchasers to be made on the basis of the order in which such persons provided for the storage of petroleum product in the Reserve. That is, sales of the Reserve's petroleum product attributable to the set-aside program will be determined to be made on a first-in-first-out ("FIFO") basis. According to the report of the Energy and Commerce Committee, in allocating proceeds received from the drawdown, the Energy Department will take into account the cash equivalent value of the oil on which the recipient's oil storage requirement was based.[19]

<u>Assessment for storage costs</u>

The bill also authorizes the Energy Department to assess and collect charges, beginning in the 1993 fiscal year, from each importer and purchaser who has petroleum product stored in the Reserve under the set-aside program. The amount of the charges assessed to any such person for any fiscal year is equal to the estimated net present value of the cost of constructing, leasing (if necessary),[20] maintaining, and administering facilities necessary for the storage of an amount of petroleum product equal to the amount of petroleum product to be stored in the Reserve during such fiscal year by such person under the bill's requirements. The net present value estimate is computed using the 10-year period beginning with the first day of the fiscal year with respect to which the assessment is made.

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18 <u>See</u> 42 U.S.C. 6241, as amended by the bill.

19 H. Rept. No. 102-474, Part 1, 102d Cong., 2d Sess., at 218.

20 The bill provides that if, at any time during the implementation of the Reserve set-aside program, there is insufficient storage capacity in the Reserve, the Energy Secretary shall, using amounts appropriated from the SPR Fill and Construction Fund, lease facilities necessary to provide sufficient storage capacity.

The bill provides that the storage charges are to be paid by the end of the fiscal year for which they are assessed. The amount of storage charges received under this provision are to be deposited in the SPR Fill and Construction Fund and may be obligated and expended by the Energy Department as provided in the bill.

Establishment of the SPR Fill and Construction Fund

The bill provides for the establishment of an SPR Fill and Construction Fund (the "Fund") in the U.S. Treasury. Contributions to the Fund will come from either of two sources: (1) cash-equivalent payments made by importers and purchasers under the Reserve set-aside program or (2) storage charges paid by importers and purchasers. Such amounts received by the Fund may be obligated and expended, to the extent provided in appropriation Acts, only for (1) the purchase of petroleum product for the purpose of filling the Reserve, and (2) the construction, leasing (if necessary), maintenance, and administration of storage facilities of the Reserve.

Authority to draw down the Reserve

Further, the bill grants additional authority for drawing down the Reserve. Under the bill, the Reserve may be drawn down if the President makes the determination that such a drawdown would assist in relieving severe economic problems directly related to a significant increase in the price of petroleum product.

Issues

The operation of the bill's Reserve set-aside program raises a number of issues. The bill leaves many of the details of administering the program to the discretion of the Energy Department. It is possible that some of the technical issues presented herein might be clarified in regulations and orders issued by that Department.

Once it is determined that filling the Reserve is a sufficiently high national priority that it be undertaken, the question of funding must be addressed. In general, it is desirable that the funding source be one which generates as little efficiency loss to the economy as possible. One aspect of efficiency loss is the economic activity deterred by the imposition of a tax or fee. A second aspect of efficiency loss is the administrative or compliance costs imposed by a particular tax or fee scheme. A sometimes competing concern is the distributional effect of a tax or fee program. The distribution among entities of burdens of a tax or fee program is often measured as a means of determining whether a particular program is equitable, in light of the benefits it provides. In order to accomplish

this, it is necessary to determine whether the parties that actually make the payments of the tax or fee are the entities which actually bear the economic burden of the tax or fee.

A large part of the cost of the set-aside requirement to importers and purchasers is the loss of the ability to freely transfer the oil to other parties through market sales. This cost can in principle be measured by the cost of carrying an asset (oil stored in the Reserve) that cannot be immediately sold at market value and transformed into cash. One can think of this as the implicit interest that could be earned on the value of the oil stored in the reserve. In addition, importers and refiners must pay the storage costs for oil stored in the Reserve. This requirement imposes an out-of-pocket cost on these parties. Since it is unclear how long the oil contributed to the Reserve will be stored there and what the future price path of oil will be, one cannot be sure what value will be given to a claim on oil stored in the Reserve. It is certain that oil stored in the Reserve will be less valuable than oil stored elsewhere that could be sold on demand. The size of the difference between these two assets might be relatively large. Presumably, a market to trade claims on oil stored in the Reserve will arise if the proposal is implemented, providing an objective measure of the loss in value caused by storage in the Reserve. Traders may find the claims on oil stored in the Reserve a valuable hedge, since the Reserve likely will be drawn down only in times when oil is relatively scarce and the market price is relatively high. At this time, though, it is difficult to predict what the market value of these claims might be in the absence of such a market.

The size of the administrative and compliance costs imposed by the storage requirement will depend on how the technical issues discussed in detail below are resolved. To the extent that a streamlined process of determining the amounts and types of oil to be contributed to the Reserve can be developed, the administrative costs can be minimized. For example, it might be desirable to designate a single point in the production chain as the point at which liability for contributions to the Reserve is determined. One possibility is the point at which imported or domestic crude oil enters a refinery or where refined petroleum is imported into the United States. Another administrative cost of the proposal might be the uncertainty surrounding the size of the required contribution to the Reserve. In particular, the Secretary of Energy is charged with determining the size of the required contribution percentage on an annual basis. To the extent the required contribution percentage changes from year to year, affected parties may find themselves subject to uncertainty about the size of the contributions in coming years. This uncertainty imposes a cost of on the affected parties. Similarly, it might be desirable to designate a single type or grade of crude oil as a benchmark for

contributions to the Reserve, eliminating concerns about differential burdens being imposed on different entities based on their utilization of different types of oil.[21]

In any event, the requirement that oil be stored in the Reserve will impose costs on society that must be borne by some entity. To the extent that the market for refined petroleum products is competitive, the costs will be passed on to the consumer of these products in the form of higher prices. In this case, importers and refiners will be made no worse off by the proposal. To the extent that the market for refined petroleum products has significant non-competitive aspects, profits in the industry will be greater than those that could be earned in other activities, and firms in the industry will bear a portion of the cost of the set-aside program in the form of reduced profits.

The bill requires that importers provide for storage in the Reserve of an amount of petroleum product equal to a percentage, to be determined by the Energy Department, <u>of the amount</u> of petroleum product they import into the United States. A similar requirement applies to purchasers for refinement of crude oil and natural gas liquids. Although not clear, it appears that the bill requires the set aside of petroleum product to be based on a specified percentage of the total volume of the product imported or purchased during a fiscal year. Alternatively, the bill's set-aside requirement could be based on the total value of such imported or purchased product.

The issue of whether the set-aside amount is based on volume or value raises some issues for consideration, especially when coupled with the provision of the bill which allows, but does not require, the Energy Department to specify the grades of crude oil which must be contributed to the Reserve. For example, consider two purchasers of domestically produced crude oil for refinement. The first refiner purchases a high grade of oil for $20 per barrel. The second refiner purchases a lower grade of oil for $10 per barrel. Assume both refiners purchase the same volume of oil during a fiscal year. Further assume that the Energy Department determines for that fiscal year that the set aside percentage is one percent of oil purchased. If the amount of product to be set aside were based on value, each refiner would have to contribute one percent of its purchased crude

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[21] Taken to the logical conclusion, this line of reasoning argues for an excise tax of X cents per barrel of oil (or refined product), with the proceeds used to purchase oil to be stored in the Reserve. By using a single medium of exchange (dollars) for all transactions and fixing the size of the tax, administrative costs are reduced.

oil to the Reserve for that year. Because the oil bought by the first refiner cost twice as much as the oil bought by the other, the first refiner would be required to contribute twice as much product, by value, to the Reserve as would the other refiner.

If the set aside were computed on a volume basis, each purchaser would be required to set aside for the Reserve one percent of the total volume of crude oil purchased during the fiscal year. Since in the example each refiner purchased a like volume of oil, each would be required to loan an equal volume to the Reserve. If the Energy Department did not exercise its authority to specify the grade or grades of oil that must be contributed to the Reserve, then each refiner might contribute the grade of oil it purchased.

Alternatively, if the Energy Department were to specify that oil contributed to the Reserve must be at least of the grade purchased by the first refiner (the $20 per barrel oil), then the refiner of the low-grade oil would be required to acquire an amount of this high-grade oil sufficient to meet its set aside requirement (or it could make a cash-equivalent payment). In this case, the amount of oil it is required to contribute would be equal to two percent, measured by value, of its total purchases of crude oil for the fiscal year, while the purchaser of the high-grade oil would be required to set aside only one percent, measured by value, of the oil it purchased during the year.

Issues might also arise under a volume-based set-aside concept if the Energy Department chose not to specify the minimum standards for product to be contributed to the Reserve. In the above example it was assumed that the purchaser of the higher-grade oil might contribute the requisite volume of that grade of oil to the Reserve. This might not necessarily be the case, however. Without a provision specifying a minimum grade of oil, that purchaser might obtain the requisite volume of a lower, less expensive grade of oil which it could contribute to the Reserve. Similarly, a company that purchases both high- and low-grades of crude oil during a fiscal year might contribute as much of its low-grade oil to the Reserve as allowed absent rules precluding this result. The bill requires the Energy Department to establish and implement rules for the set-aside program. The bill and legislative history provide no specifications as to how to allocate the product to be contributed among the various grades of product produced, imported, or available during the year.

Another issue raised by the bill involves the requirement that a person purchase domestically produced crude oil or natural gas liquids for refinement in order for the set-aside liability to arise. Such a requirement might favor, for example, a fully integrated company or group of

companies related by common ownership (i.e., a company, or group of related companies, that engages in both domestic exploration and production of oil and gas as well as refining of the oil and gas it produces). In this case, the refining arm of the company might be able to obtain the oil and gas for refinement without entering into a purchase transaction. A literal reading of the bill would not impose a set-aside requirement on the oil and gas obtained in this manner, thus placing such a company (or companies) at a competitive advantage vis-a-vis refiners who must purchase the oil and gas they refine.

Congress addressed a similar issue in 1980 when it enacted section 4611 of the Internal Revenue Code.[22] Section 4611 imposes a petroleum excise tax for the Oil Spill Liability Trust Fund. The petroleum excise tax is imposed on (1) petroleum products entered into the United States for consumption, use, or warehousing or (2) crude oil received at a United States refinery. It appears that the petroleum excise tax generally is intended to be imposed on the same persons and on a similar basis as the Reserve set-aside requirement. However, the imposition of the excise tax on the basis of petroleum product imports and crude oil received at refineries appears to avoid the issue of identifying purchase transactions in order for liability to arise.

The bill specifies that each importer or purchaser providing petroleum product under the bill will retain and may freely transfer title to such petroleum product. If the petroleum product to which the importer or purchaser holds title is eventually sold from the Reserve, the title holder is entitled to the proceeds from such sale.

In lieu of contributing petroleum product to the Reserve, persons may elect to pay an amount of cash equivalent to the value of petroleum product required to be so contributed. The bill's provisions do not detail the treatment applicable in the case of persons making cash-equivalent payments. For example, the bill provides that cash-equivalent payments shall be deposited in the SPR Fill and Construction Fund and may be obligated and expended by the Energy Department, to the extent provided in appropriation Acts, only for (1) the purchase of petroleum product for the purpose of filling the Reserve and (2) the construction, lease, maintenance, and administration of Reserve storage facilities. Thus, the bill does not mandate that all cash-equivalent payments received by the Fund be expended specifically for the petroleum product that would have been required to be contributed by the importer or purchaser absent the cash-equivalent payment. Instead, the

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22 P.L. 96-510, sec. 211(a).

bill gives the Congressional appropriators the flexibility of using those monies for purposes of obtaining or maintaining storage space for the Reserve. This being the case, it appears that whereas a person contributing petroleum product to the Reserve receives title to such product, a person contributing cash in lieu of petroleum product may not receive title to petroleum product (if any) purchased by the Fund with such cash. If the Fund does purchase petroleum product with the cash, it appears that title to the product is not passed to the person, and any proceeds from the eventual disposition of the product by the Reserve would be the property of the Federal Government.

A further issue raised by the bill involves the tracking of ownership of the petroleum product held by the Reserve and the determination by the Federal Government upon drawdown of the Reserve of which owners' products have been disposed of. Under the bill, when the petroleum product stored in the Reserve under the set-aside provisions is distributed as a result of a drawdown on the Reserve, the Energy Department must provide for the payment to each importer or purchaser (or such person's assignee) of the amount received for the sale of the petroleum product stored in the Reserve as a result of actions taken by such importer or purchaser. The Reserve will contain a cumulative amount of petroleum product--only a portion of which will have been contributed to it under the bill's set-aside program. In determining which petroleum product in the Reserve has been stored there under the set-aside program, the Energy Department is to consider the first amount of petroleum product withdrawn from the Reserve (to the extent of the total amount of the petroleum product stored therein under the set-aside program) to be the petroleum product stored in the Reserve under the program. Thus, the Energy Department would treat all of the set-aside petroleum product as being disposed of from the Reserve before petroleum product obtained by the Reserve from any other source.

In addition, the bill provides that the Energy Department must provide for the payments to importers and purchasers to be made on a first-in, first-out (FIFO) basis. That is, petroleum product disposed of from the Reserve is treated as coming first out of the petroleum product that has been in the Reserve for the longest period of time under the set-aside program. The bill does not provide any further guidance as to how the sale of Reserve petroleum product is to be administered. An issue that might arise involves the various grades of crude oil and refined products that are maintained in the Reserve. For example, assume that the Reserve contains three grades of crude oil: a low grade, a medium grade, and a high grade. Further assume that the person who holds title to the crude oil that has been in the Reserve the longest under the set aside program originally contributed low-grade oil to the reserve. It is unclear

under the bill whether the proceeds of the first oil sold by the Reserve during a drawdown would be attributed to that person regardless of the grade of oil sold. That is, the bill does not clarify whether all petroleum product held by the Reserve under this program will be treated as fungible, or whether inventories will be maintained and title holders matched to the various types and grades of product that are contributed to and maintained within the Reserve.[23]

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23 A similar arises as a result of the maintenance in the Reserve of both crude oil and refined petroleum product.

D. Abandoned Mine Reclamation Fund

Present Law

The Surface Mining Control and Reclamation Act of 1977, as amended (30 U.S.C. 1232(b)), imposes a reclamation fee on coal mining operaters, payable quarterly to the Secretary of the Interior for deposit in the Abandoned Mine Reclamation Fund ("Reclamation Fund"). The fee generally is the lesser of (1) 35 cents per ton of coal produced by surface coal mining and 15 cents per ton of coal produced by underground mining, or (2) 10 percent of the value of the coal at the mine. The fee for lignite is the lesser of 2 percent of the value of the coal at the mine or 10 cents per ton.

The reclamation fee is scheduled to expire after September 30, 1995 (as extended in the Omnibus Budget Reconciliation Act of 1990).

Explanation of Provision

As reported by the Committee on Interior and Insular Affairs, the bill extends the coal reclamation fee through September 30, 2010, and provides that $50 million of the amounts available in the Reclamation Fund in each fiscal year be deposited into a new "Coal Industry Retiree Benefit Fund" (yet to be established).