Energy

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For more information, contact:

Monica Hwang
+1 713 276 7346
mhwang@kslaw.com

Rick Vacura
+1 703 245 1018
rvacura@kslaw.com

Chelsea Vernon
+1 713 276 7334
cvernon@kslaw.com

King & Spalding
Houston
1100 Louisiana Street
Suite 4000
Houston, Texas 77002-5213
Tel: +1 713 751 3200

Washington, D.C.
1700 Pennsylvania Avenue, NW
Washington, D.C. 20006-4707
Tel: +1 202 737 0500

Government Offers Storage at the Strategic Petroleum Reserves for U.S. Produced Crude Oil

Previously, on Friday, March 13, President Trump announced he had directed the U.S. Department of Energy (the "DOE") to begin purchasing oil for the Strategic Petroleum Reserves (the "SPR"). The DOE immediately took action on March 19 by issuing a request for proposal ("RFP") for thirty million barrels of crude oil. However, this plan was scrapped after the DOE failed to secure funding as part of the CARES Act stimulus bill signed in March.[1]

As an alternative, on April 2, the Trump administration announced the DOE would instead lease space within the SPR to private companies. Following this announcement, the DOE released an RFP to provide crude oil storage for 30,000,000 barrels through time exchanges. All submissions for this RFP must be received no later than 11:00 a.m. Central Time, Thursday, April 9.[2] Based on the foregoing, further RFPs are expected in the coming months with the DOE projected to lease storage for a further 47,000,000 barrels of crude oil produced in the U.S.

Similar to the previous RFP for SPR purchases, this RFP is restricted for storage of U.S. produced crude but the limitation on the producer size has been eliminated. As with the previous RFP, it is important for bidders to be aware of the additional risks related to certifications and compliance measures required of companies contracting with the government.

OVERVIEW OF THE SPR

It is worth reiterating the background of the SPR, which was created as an emergency supply of crude oil in the 1970s following the 1973 – 1974 oil embargo. Its purpose is to reduce the impact of disruptions to the U.S. supply of oil in the event of other oil embargos, natural disasters, etc. It is also fundamental to the U.S. for meeting its International Energy Agency obligations, which requires member countries to maintain a supply of emergency oil stocks. The SPR is the world's largest supply of emergency crude oil with an authorized capacity of 713.5 million barrels

and is stored in underground salt caverns along the U.S. gulf coast at four sites – two in Texas and two in Louisiana.

It appears that this is the first time the DOE has ever leased storage space in the SPR to private companies. In 2018 the House of Representatives attempted to permit the DOE to lease space in the SPR to private companies; however, the bill the House of Representatives passed was never taken up by the Senate.[3] Recently, the DOE has announced it would lease storage space in the SPR to the Australian government to store that country's strategic reserves.[4]

OVERVIEW OF THE RFP

The RFP is targeted at "crude oil produced in the United States for fulfillment purposes".[5] The bidder, however, can be a regular crude seller or distributor so long as it provides certification that the crude oil is supplied by U.S. entities, which are defined as individuals, corporations, partnerships, or governmental entities and which are U.S. citizens, incorporated or organized in the U.S. or governmental entities of the U.S. or one of its states.[6] Thus, qualifying U.S. producers can participate indirectly with a trader or major producer acting as the aggregator. This RFP does not have the size limitation for U.S. producers which was in the RFP for SPR purchases (i.e., requiring that qualifying U.S. producers are those with less than 5,000 employees). Because the crude oil is sourced domestically, even marine deliveries must be made by U.S. flagged vessels pursuant to the Jones Act.[7]

The delivery period to the SPR is for the months of May and June of 2020, and such crude oil must be withdrawn by the winning bidders by March 31, 2021.[8] Each award is capped at 5,000,000 barrels, and each bidder is limited to a maximum award of 10,000,000 barrels.[9] Thus, a minimum of six awards may be expected. Bidders will propose the monthly fixed exchange ratio, which is the ratio of barrels to be retained by the DOE and deducted from the quantity to be returned to the winning bidder in the second leg of the exchange. The ratio will be applied to the maximum storage and exchange capacity awarded (and not the inventory balance) to determine the quantity to be retained by the DOE, and bids will be evaluated primarily on the best barrel exchange ratio offered.[10]

COMPLIANCE REQUIREMENTS

Because the government as a contracting party operates under extensive and complex procurement statutes, regulations and rules that are different than the commercial marketplace, contracting with the government as a prime or subcontractor[11] may pose significant financial risks, and even may result in administrative sanctions, or civil and criminal liability for noncompliance. For example, all potential bidders must register in the System for Award Management ("SAM") and provide representations and certifications that are unique to doing business with the government and are made under penalty of the False Statements Act, 18 U.S.C. 1001. In addition, the requirements listed in the RFP cover eleven pages of Federal Acquisition Regulation ("FAR") and FAR-like clauses, some of which are incorporated by reference.[12]

The one week time period (April 2-9) to prepare and submit a bid for the RFP may be a challenge for companies unfamiliar with the required procedures and regulations involved. Companies that regularly contract with the government mitigate the risk by having well-developed internal systems and processes to ensure compliance with these government-unique requirements. Potential bidders to the RFP and producers that may supply the crude to such bidders would be well served to make sure they understand how their current compliance policies and procedures may need to be enhanced to mitigate the risk when contracting with the government.

TAKEAWAY

The RFP targeted at crude oil produced in the U.S. has likely piqued the interest of U.S. producers and crude traders seeking ways to store crude in the current low price environment. For bidders seeking to contract with the U.S. government for the first time, understanding the additional regulatory requirements to contract with the government is important to mitigate the risks related to government-unique compliance requirements and to improve a bidder's chance

of preparing a winning bid. A potential bidder to this RFP would be well advised to engage legal counsel early in the process to navigate regulatory compliance matters.

[1] *See* Timothy Gardner and Laila Kearney, *U.S. to lease space for initial 30 million barrels of oil in emergency reserve*, Reuters (April 2, 2020).
[2] *See* https://www.spr.doe.gov/doeec/2020-04_OilExchange/Docs/ExchangeForStorageRFP.pdf for the full text of the current RFP.
[3] *See* S&P Global Platts, *US study to focus on leasing, not closing, portions of SPR: sources*, (Aug. 19, 2019).
[4] *See* Energy.gov, *U.S. and Australia Strengthen Fuel Security with New SPR Arrangement*, (March 10, 2020) (https://www.energy.gov/articles/us-and-australia-strengthen-fuel-security-new-spr-arrangement).
[5] *See* footnote 1, at Sec. B.1.a.
[6] *Id*. at Sec. B.1.b.
[7] *Id*. at Sec. F.1.i.
[8] *Id*. at Sec. B.1.a.
[9] *Id*. at Sec. B.1.d.
[10] *Id*. at Sec. B.5.
[11] The definition of "subcontractor" in the FAR at 48 C.F.R. § 44.101 is extremely broad and would include companies selling to the prime contractor under the RFP. In addition, the prime contractor must flow down mandatory FAR clauses that also subject subcontractors to the above-described risks.
[12] *Id*. at Sec. I.