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BY THE U.S. GENERAL ACCOUNTING OFFICE

# Report To The Chairman, Subcommittee On Oversight And Investigations Committee On Energy And Commerce House Of Representatives

# Reasons And Current Outlook For The Sale Of Federal Royalty Oil To Small And Independent Refiners

The Department of Interior receives a royalty from oil produced on federal lands. Interior can take the royalty as a cash payment or a portion of the oil itself, which it can then sell to small and independent refiners who are determined to be in need of crude oil supplies. Sales of this so-called royalty oil have been held about every 3 years since 1970. In early 1985, Interior announced its intention to terminate the program because of its declining importance and proposed legislation to that effect. While GAO sees no compelling need to legislatively restrict Interior's ability to hold future royalty oil sales now or in the future, it has identified several ways to improve the program's effectiveness.

This report examines Interior's basis for the most recent sales and the current status and need for the royalty oil program and discusses ways in which its administration might be improved if future sales are held.

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WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

B-215016

The Honorable John Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

As requested in your letter of August 8, 1983, this report examines the Department of the Interior's 1983 basis for determining a need to sell federal royalty oil to eligible refiners, and examines other related matters as well.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time, we will send copies to the Department, Members of Congress, and other interested parties and make copies available to others upon request.

Sincerely yours,

J. Dexter Peach
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE CHAIRMAN
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS, COMMITTEE
ON ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

REASONS AND CURRENT OUTLOOK
FOR THE SALE OF FEDERAL
ROYALTY OIL TO SMALL AND
INDEPENDENT REFINERS

## DIGEST

The Department of the Interior administers about 18,000 producing or producible oil and gas leases on federal onshore and offshore land, which in 1984 produced over half a billion barrels of oil. Interior collects royalties from these leases, which typically are one-eighth of the value of oil produced onshore and one-sixth of the value from offshore production. Interior can take the royalty in the form of a cash payment based on the lessees' selling price, or the oil itself (that is, in-kind)--commonly referred to as royalty oil. In 1984, about 33 percent of all oil royalties were taken in-kind. Amounting to 27 million barrels, this royalty oil was worth about $800 million.

The Mineral Leasing Act of 1920 and the Outer Continental Shelf Lands Act provide that Interior can sell royalty oil to eligible refiners that are having difficulty obtaining adequate supplies of crude oil. Prior to doing so, however, the Secretary must determine that satisfactory supplies of oil are not available on the open market.

Offshore and onshore sales are held separately because the authorizing legislation for each is different; that is, offshore oil is available only to small refiners with capacities and employees not exceeding 45,000 barrels a day and 1,500, respectively, while onshore oil is available to independent refiners not having their own source of oil. Because the amount of oil available for sale is generally much lower than the amount refiners ask for, the oil is divided equally among the participating refiners and sold under multiple-year contracts. The contracts can be amended or unilaterally terminated by either Interior or the refiner. Such sales have been held about every 3 years since 1970. The last sales were held in 1983, when the government offered 1-year contracts to small refiners for a total of 140,000 barrels of oil a day from offshore

leases--primarily Gulf of Mexico oil--and 2- and 3-year contracts to independent refiners for a total of about 30,000 barrels a day from onshore leases.

The program, administered by Interior's Minerals Management Service, is of relatively low cost to the government--the refiner receives the oil from the producer and pays Interior the same amount Interior would otherwise receive from the producer in royalty cash payments. Interior's cost to administer the program was about $570,000 in fiscal year 1984, but in 1985 Interior took steps toward having the participating refiners pay these costs, and plans to fully recover such costs in future sales.

The Chairman of the House Energy and Commerce Committee's Subcommittee on Oversight and Investigations asked GAO to examine the basis for Interior's 1983 determination of need, particularly in view of the ample supplies of crude oil in the world market, and to look at alternatives to improve the program. GAO examined available Interior Department records, laws, regulations, and legislative histories, and also attempted to gain a perspective of the refiners' situation by talking to 84 refiners--including those who were, as well as to some who were not, receiving royalty oil in 1984 and 1985. GAO also talked with government and oil industry representatives.

## INTERIOR'S JUSTIFICATION FOR THE 1983 SALES MET LEGAL REQUIREMENT

The legislation requiring a Secretarial determination to provide royalty oil to small and independent refiners leaves to the Secretary's discretion the decision as to whether a need for oil exists among the refiners. The Mineral Leasing Act states that inasmuch as the public interest will be served by the sale of royalty oil to refineries not having their own source of supply, the Secretary of the Interior is authorized to hold sales where he determines sufficient supplies of crude oil are not available in the open market to such refineries. Similarly, the Outer Continental Shelf Lands Act provides for sales when the Secretary determines that small refiners do

not have access to adequate supplies of crude oil at equitable prices. Neither law required the Secretary to make a detailed analysis to support such a determination.

Interior's 1983 determination of need was not based on any detailed analysis but met the requirements of the authorizing legislation. It was based on the fact that previous royalty oil contracts were expiring; strong refiner interest in continuing to receive royalty oil; and Interior's belief that small and independent refiners could not continue to exist without government royalty oil. In further elaboration, Interior advised GAO in a letter dated June 11, 1984, that the royalty oil program was viewed as a permanent underpinning for the small and independent refining industry, citing (1) small refiners' claims that they were unable to obtain sufficient oil supplies elsewhere, (2) invasion of traditional small refiners' markets by large, integrated oil companies with their own refining operations, and (3) increased small refiner bankruptcies.

## CURRENT PLANS TO TERMINATE THE ROYALTY OIL PROGRAM

In early 1984 GAO found that there were 45 refiners with royalty oil contracts for nearly 100,000 barrels of oil a day, and many that GAO spoke with at that time said they were having difficulty obtaining crude oil at competitive prices. As 1984 progressed, however, many refiners, particularly those obtaining royalty oil from Gulf of Mexico leases, began finding it possible and more advantageous--that is, cheaper--to obtain crude oil elsewhere. Several refiners told GAO that they withdrew from the program for that reason; others said they withdrew because even with the availability of crude oil they still could not operate profitably and had to close their refineries. Only 28 refiners were still receiving oil in February 1985, and only 46,000 barrels a day were still under contract, primarily for west coast offshore oil and onshore oil.[1]

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[1]Although the 1-year contracts for offshore oil had expired, refiners had the option of extending them.

Although Interior had earlier stated that the program was viewed as a permanent underpinning for the small refiners, Interior currently does not plan to hold any further sales. While a 1984 sale was planned, Interior initially deferred it pending finalization of new regulations, which would have placed all royalty oil sales under one set of regulations, although still with different refiner eligibility criteria for onshore and offshore sales. Plans for additional sales and publication of new regulations were cancelled in early 1985, however, when the Office of Management and Budget, in reviewing Interior's 1986 budget, deleted the program from the budget. Interior cited as reasons the decreasing number of participating refiners and the prevailing and expected conditions in the petroleum markets. In addition, Interior's Associate Director for Royalty Management said that it would be difficult to make a determination justifying a nationwide need for the program at this time. Although those contracts that would have expired were extended, Interior's fiscal year 1986 budget proposal provides for phasing out the program and offers draft legislation that the royalty oil program not be instituted again except in a national emergency.

SHOULD INTERIOR'S AUTHORITY TO HOLD FUTURE ROYALTY OIL SALES BE RESTRICTED?

While the Department's determination to sell royalty oil in 1983 met the legal requirements of the authorizing legislation, the number of refiners participating in the royalty oil program is down considerably, and in recent months the decline can be attributed to a lessening need for royalty oil by small or independent refiners. Further, the program does not appear to represent a major source of oil for most of the remaining participants, and it is difficult to substantiate the relative importance of royalty oil to them.

On the other hand, those remaining participants find the program of value and consider its continuation important. This seems to be particularly true in the Rocky Mountain and West Coast areas where 26 of the remaining 28 participants, who are receiving 95 percent of

the 46,000 barrels a day still under contract, are located. Twenty-four of these refiners told GAO they are still anxious to participate in the program--mainly because of (1) the difficulty in obtaining crude oil from major producers and (2) their remoteness from the Gulf Coast where the bulk of the available oil exists.

Although the need for the program now appears to be limited to a small number of refiners--primarily those in the western United States--changes in oil prices and availability could increase refiners' need for the program. Further, Interior was in the process of instituting a fee to recover the costs of administering the program. Such a fee would cost refiners only a few cents a barrel. While the need for royalty oil has lessened in the last 2 years, there is no compelling reason to eliminate the program if it remains Congress' desire to retain a mechanism for aiding small and independent refiners having difficulty in obtaining crude oil.

Should sales be held in the future, GAO has several suggestions for possible ways to improve the program's effectiveness. In particular, Interior should follow through on its plan to recover the cost of administering the program.

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GAO discussed its findings with agency program officials and has included their comments where appropriate. However, GAO did not obtain the views of responsible officials on its conclusions, nor did it request official agency comments on a draft of this report.

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## ABBREVIATIONS

| | |
|---|---|
| b/d | Barrels a day |
| DOE | Department of Energy |
| GAO | General Accounting Office |
| MMS | Minerals Management Service |
| OCS | Outer Continental Shelf |
| OMB | Office of Management and Budget |
| SBA | Small Business Administration |
| USGS | U.S. Geological Survey |

# CHAPTER 1

## INTRODUCTION

As of the end of 1984, there were more than 16,700 producing and producible federal oil and gas leases in 25 states, along with 1,466 such leases on the Outer Continental Shelf (OCS). These federal leases produced 522 million barrels of oil in 1984, or about 16 percent of all U.S. oil production. The government, through the Department of the Interior's Minerals Management Service (MMS), collects royalties from these leases which typically are one-eighth of the value of the oil produced onshore, and one-sixth of the value of OCS, or offshore, oil. In fiscal year 1984, the federal share of this production was nearly 82 million barrels, valued at $2.4 billion.

The Mineral Leasing Act (30 U.S.C. 192) and the OCS Lands Act (43 U.S.C. 1353) are the statutory authorities for federal oil and gas leasing. Both of them give the Secretary of the Interior the discretion to take royalties owed the government in the form of a cash payment based on the lessee's selling price, or the oil itself (that is, in kind). If the Secretary elects to take the royalty in kind, the leasing laws also enable him to sell this so-called "royalty oil" to refiners if he determines that they have a need for it. The Mineral Leasing Act authorizes sales of onshore oil to any refinery without its own supply of crude oil if the Secretary determines that sufficient supplies are not available in the open market. Section 36 specifically states

> "That inasmuch as the public interest will be served by the sale of royalty oil to refineries not having their own source of supply for crude oil, the Secretary of the Interior, when he determines that sufficient supplies of crude oil are not available in the open market to such refineries, is authorized and directed to grant preference to such refineries in the sale of oil under the provisions of this section, for processing or use in such refineries and not for resale in kind, and in so doing may sell to such refineries at private sale at not less than the market price any royalty oil accruing or reserved to the United States under leases issued pursuant to this chapter. . . ."

The OCS Act defines the conditions for sale of offshore oil somewhat differently, authorizing sales only to small refiners whenever the Secretary finds that these refiners are unable to obtain adequate supplies of crude oil at equitable prices. The law says:

> "Whenever, after consultation with the Secretary of Energy, the Secretary determines that small refiners do not have access to adequate supplies of oil at equitable prices, the Secretary may dispose of any oil which is taken as a royalty . . . by conducting a lottery for the

sale of such oil, or may equitably allocate such oil among the competitors for the purchase of such oil, at the regulated price, or if no regulated price applies, at its fair market value."

In addition to differences in the conditions that precede a sale, the two laws differ in their definitions of intended beneficiaries. We were unable to determine from the legislative histories the reasons for the two separate definitions. Although the purpose of the preference under the Mineral Leasing Act is to assist small business enterprise by encouraging the operation of oil refineries not having an adequate supply of crude oil, the act describes eligible refineries as those not having their own source of crude oil; no further definition is given. The OCS Act, on the other hand, refers specifically to small refiners, and defines the term as that used by the Small Business Administration (SBA). Currently, the SBA defines a small refiner as one whose refining capacity does not exceed 45,000 barrels a day, and having not more than 1,500 employees. Interior had attempted to use the SBA criteria to determine eligibility for both onshore and offshore sales, but a 1979 court ruling held that this could not be done. Interior's current criterion for onshore eligibility is that a participating refiner cannot own or control over 30 percent of the crude oil it refines.

## HOW THE ROYALTY OIL PROGRAM WORKS

Royalty oil sales are handled by MMS and consist essentially of the following actions: (1) determination by Interior of a need for the sale, announced in the Federal Register, (2) public (Federal Register) announcement of oil availability based on anticipated production from the leases selected for inclusion in the sale, including a request for applications to purchase the oil, (3) refiners' requests to purchase specific quantities of oil, (4) screening of applicants by MMS to determine eligibility, (5) allocation of oil to eligible applicants, and (6) the sale, generally involving 3-year contracts.

Because the amount of oil for sale is generally much lower than what refiners request, they are each allotted an equal share of the total, unless they request a smaller amount. Under the OCS Act, the Secretary is permitted to equitably allocate oil among refiners or to sell the oil by lottery; the Mineral Leasing Act allows the Secretary at his discretion to prorate shares among the refineries in the area in which the oil is produced--a so-called geographic preference.

Once the available oil is allocated among all eligible applicants, refiners, based on an order determined by a lottery, select the leases from which they want their oil to be delivered. In some cases refiners may have to select leases located so far from their refineries that transporting it is not practical. This

necessitates that they work out exchange arrangements to obtain oil that is closer to them or to obtain oil of a more suitable quality than that which they have been allocated. In addition, before contracting to purchase the oil, refiners are required to make arrangements for surety (bonds or letters of credit). If the surety cannot be obtained, or any needed exchange agreements cannot be made, the refiners turn back the oil and Interior resumes taking its royalty in cash rather than in kind until it is reoffered in the next sale. The contracts can also be terminated by either party, or amended.

Specific amounts of oil cannot be contracted for since MMS can only estimate, based on past production, what any lease's future production is likely to be. For those leases involved in the program, MMS then directs the lease operator to make the federal share of production available to the appropriate refiner and, as MMS receives production reports from the lease operator, MMS bills the refiner for the amount of money it would otherwise have received in royalties. Interior also used to bill the refiners an additional 1/2 of 1 percent of the price of the oil to cover the cost of administering the program. However, the Interior's Solicitor's Office concluded that the fee for OCS sales should be, but was not, based on actual costs incurred. Accordingly, no fee was charged in the last sales held in 1983, although Interior--at the urging of the Office of Management and Budget (OMB)--began to charge a monthly fee of $150 a lease under contracts recently extended for offshore oil and plans to add similar fees to onshore contracts if these contracts are extended or any future sales are held. Interior estimated the cost of administering the program in fiscal year 1984 to be $570,000 and $450,000 in 1985, and proposed fiscal year 1986 costs in its budget of about $130,000.

## ROYALTY SALES TO DATE

Although the Secretary of the Interior has had the authority to sell royalty oil since 1920, when the Mineral Leasing Act was passed, refiners had little interest in the oil until the 1970's, and few sales were held before then. The first sales were held in the late 1940's, largely as a result of west coast refinery shortages after World War II. West coast refiners continued to be the major customers for the few sales held during the 1950's and 1960's.

By 1970, however, after U.S. oil production had started to decline, interest in royalty oil increased. The 1970 sale of onshore royalty oil drew many refiners, and Interior continued to hold sales regularly since then, approximately every 3 years. The first OCS royalty oil offering was made in 1972, and both onshore and offshore sales were held again in 1976. The next sales should have been held in 1979, to coincide with the expiration of the 3-year contracts. But with the creation of the Department of Energy (DOE) in 1977, responsibility for issuing regulations on royalty oil sales was transferred from Interior. DOE's delay in

issuing regulations put off the next sales to 1980. In 1981 regulatory responsibility was legislatively transferred back to Interior, and in 1982 an interim sale was held to dispose of onshore oil turned back by refiners who had cancelled their 1980 contracts.

The most recent sales were held in 1983; one sale of OCS oil in October and two onshore oil sales in November and December. To even out its workload, MMS staggered the contract periods--issuing 1-year contracts for OCS oil, 2-year contracts for onshore oil sold in November, and 3-year contracts for onshore oil sold in December--with an intent to issue any future contracts for a 3-year period. (See app. II for additional information on recent sales.)

The royalty oil offered for the 1983 sales amounted to about 90 percent of all oil that was available from OCS producing leases, and about half of what was available from onshore leases. In total, about 80 percent of all federal oil was made available from 817 leases. As a matter of expediency, the onshore leases included were the same as those included in previous sales. The only OCS leases that were not included in the 1983 sales were those with production of 50 barrels a day or less, and those whose production may overlie both state and federal lands, but for which the disposition of revenues has not been agreed upon. For its planned 1984 sale, however, Interior intended to examine all onshore leases for possible inclusion, but to reduce the amount of OCS oil offered by selecting only those leases producing more than 200 barrels a day (b/d). The latter change was expected to simplify administration of the program by dropping about 175 leases which produce about 11,000 b/d of royalty oil.

## The 1983 sales

For its 1983 sales, Interior made available a total of 168,630 b/d of royalty oil from 817 leases and unit agreements,[1] most of which--137,534 b/d--was OCS oil. This offering was even larger than that made in 1980, when 151,523 b/d were made available, again with OCS oil the major source.

The amount of royalty oil offered was nonetheless considerably less than what refiners asked for in 1983. Most refiners participating in the 1983 sales requested onshore and OCS oil in amounts that, either separately or in combination with other supplies, would fully satisfy their operating capacity. Fifty-three refiners asked for close to 550,000 b/d of OCS oil, four times as much as was offered. Geographic preferences were made in the

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[1]A unit agreement is a fairly common arrangement in the oil and gas industry wherein two or more lessees or owners combine their tracts of land for production under a single operator.

onshore sales. For the sale of onshore oil in the western and south central United States, 40 refiners asked for over 600,000 b/d compared with about 8,000 b/d offered. And for the second sale of onshore oil, from leases in the north central states, 11 refiners asked for 113,300 b/d, over four times what was offered (24,795 b/d).

Despite the large amount of oil refiners requested, only about 58 percent of the oil offered was contracted for initially, generally because many refiners who were allocated oil were unable to work out exchange agreements or obtain surety. As of March 1984, 45 refiners had contracts for an estimated 98,000 b/d of royalty oil. Because of continuing refiner difficulties and because of an increase in crude oil availability from other sources, other refiners subsequently terminated their contracts. By February 1985 participation had dropped to 28 refiners, with contracts of 46,000 b/d, or about 27 percent of the royalty oil initially made available.

## ANNOUNCED TERMINATION OF THE PROGRAM

Although initially planned as a follow-on to the 1-year OCS contracts in 1983, no sale was held in 1984. MMS was in the process of revising its regulations to make a number of procedural and administrative changes, and extended the contracts due to expire in 1984, so that new sales could be held after the new regulations were finalized. Before the regulations were published, however, Interior's fiscal year 1986 budget proposal was released showing that the royalty oil program was to be terminated. Interior's budget proposal cited that the scarcity of crude oil was no longer critical, that participation was declining, and that litigation was ensuing from the program. In addition, the budget proposed legislation that the government would no longer take royalties-in-kind except after a declaration of a national emergency--in effect, legislatively terminating the program.

## OBJECTIVES, SCOPE AND METHODOLOGY

Upon learning of the Interior Secretary's decision to make royalty oil available to small refiners in 1983, the Chairman, House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, asked GAO to examine the basis for the Secretary's determination that small refiners were in need of the oil, particularly in view of the ample supplies of crude oil in the open market. (See app. I.) The Chairman asked us also to examine the justification for prior sales and to consider alternatives to improve the program. We also examined several related management and procedural aspects of the program.

To find out how Interior determined that small refiners needed royalty oil, in the last and previous sales, we obtained the views of the Director of the MMS, the Interior agency responsible for administering the royalty oil program, and other MMS

officials. Information on prior years' sales was limited, but we did interview officials in the U.S. Geological Survey (USGS), which had responsibility for the royalty oil program until 1982. We reviewed the authorizing legislation, agency regulations, Federal Register announcements of sales, and MMS internal documents relating to the sales. We also attended the three sales held in 1983.

Because Interior had little documented justification for its determination of a need for the 1983 sales, and because of crude oil price variations by location, by grade, and over time, it was difficult to quantitatively establish the extent or severity of crude oil shortages or their impact on a given refinery or refiners. We therefore relied heavily on industry interviews to substantiate Interior's determination of need, and to determine the importance of the program to the small and independent refiners. Initially, we used a nonscientific sample of refiners, which concentrated on those refiners owning refineries in the three states--California, Louisiana, and Texas--that contain close to half of the refineries in the United States. We also chose three lease operators to talk with, primarily because they operated both onshore and offshore leases that together produced about 32 percent of the royalty oil MMS offered in 1983.

To determine how important the royalty oil program is to refiners, and to identify any problems with it, we interviewed MMS officials, 84 refiners, three operators of leases from which royalty oil is taken, and two refiners' associations. Because of their impact on Interior's determination and refiner participation, we also considered several legal aspects of the royalty-in-kind program, including Interior's flexibility in setting refiner eligibility criteria for both onshore and offshore oil, the implications of the court case that invalidated Interior's previous onshore criteria, the type of justification legally required of Interior for the program, and any legal requirement for Interior to recoup any related administrative costs.

We also identified two other means by which federally owned or controlled oil is sold to small refiners that might be considered as alternatives to the royalty program.

In our initial sample of refiners, we attempted to select refiners who displayed a number of different characteristics pertaining to the royalty program--refiners purchasing royalty oil, refiners not purchasing royalty oil but who had applied, refiners who had not applied, and inactive refiners. This resulted in our contacting and visiting 30 refiners owning 35 refineries. Of the 35 refineries, 32 were located in the states of California, Louisiana, and Texas. The three remaining refineries were located in Arkansas, Utah, and Washington. During this process we also contacted an additional 17 refiners, and unsuccessfully attempted to contact 11 others, who had not participated in the 1983 sales. Most of these unsuccessful attempts involved inactive refiners.

Subsequently, several refiners voluntarily withdrew from the program, and Interior disclosed its intent to terminate the royalty program. We therefore conducted another series of interviews designed to focus on any recent changes in the importance of or need for the royalty oil program. We focused on refiners who were purchasing royalty oil as of February 1985 and those active refiners with refining capabilities limited to refining 45,000 b/d of oil or less that were not owned by a major oil company. Refiners of this capability were chosen because they were generally eligible for both onshore and offshore royalty oil. We estimated that there were 183 such refineries and found that 39 were inactive. We contacted 58 refiners in this effort, 21 of whom we had previously contacted.

All together, we contacted 84 eligible refiners in the United States. An additional 24 we attempted to contact could not be reached and, presumably, many of them are no longer in operation. Thirty of the 84 were actually visited; the others were asked a series of standardized questions in telephone interviews. The 108 refiners we contacted or attempted to contact represented virtually every active small refiner we were aware of.

We also examined certain administrative aspects of the royalty program--payment collections and refiner eligibility. First, we examined a number of royalty oil billings and payments to assure that MMS was receiving the full amount due it for oil provided to the participating refiners. We reviewed billings for selected 1983 royalty oil sales to determine if amounts paid by refiners were the same as amounts that would be received in the absence of a royalty oil program. This review was limited to offshore leases where both royalty-in-kind as well as royalty-in-value payments were occurring from the same lease. A total of 27 such leases were identified, 14 of which we selected for review. In addition, the leases selected were operated by different companies. This review also involved comparisons of royalty oil values prior to royalty oil deliveries as well as while royalty oil deliveries were taking place and generally involved the months of December 1983 and January and February 1984. Since no unreconcilable differences were found, we did not pursue this matter further.

Last, we attempted to determine whether the onshore royalty oil participants were eligible for the program, that is, whether they controlled over 30 percent of their crude oil input. We examined the data submitted by onshore participants as to their other sources of oil. We found one refiner that controlled over 30 percent of its crude oil input. We advised MMS of this, and MMS in turn terminated the contract.

We conducted this review between October 1983 and February 1985. We discussed our findings with agency program officials and have included their comments where appropriate. At the request of the Subcommittee, we did not obtain the views of responsible

officials on our conclusions, nor did we request the Department of the Interior to review and comment officially on a draft of this report. Except as noted above, our work was performed in accordance with generally accepted government auditing standards.

## CHAPTER 2

## JUSTIFICATION AND NEED FOR

## ROYALTY OIL SALES

Interior's 1983 sales were preceded by a formal determination that small refiners were continuing to find it difficult to obtain supplies of crude oil. Although Interior did not conduct a detailed analysis of small refiner needs, the oil and gas leasing laws require only that such a determination be made, without specifying how or defining key terms. Interior's published statements and its determination appear to satisfy legal requirements.

With contracts for earlier royalty oil sales about to expire, Interior proceeded with its 1983 sales on the basis of small refiners' expressed need for royalty oil and Interior's perception of the state of the small refinery industry. Interior could not provide us any studies or analyses on crude oil prices and availability or on the small refiners' situation.

Subsequently, in early 1985, Interior announced that the royalty program was being phased out. Interior's budget proposal attributed this to declining refiner participation and prevailing and expected conditions in the petroleum markets. While crude oil prices have eased since the 1983 sale determination to the point where MMS believes that it would currently be hard to justify the program's need on a nationwide basis, some west coast and Rocky Mountain area refiners are still having difficulty obtaining crude oil at satisfactory prices. Further, past experience has shown that the crude oil supply situation is dynamic.

### BASIS FOR THE 1983 SALES

In a November 1982 Federal Register notice, MMS announced that because royalty oil contracts issued in 1980 would expire in mid-1983, it was the agency's intent to hold another sale of royalty oil the following year. Before holding the sales, however, the Interior Secretary had to make a formal determination of refiners' need. Because of the differences between the Mineral Leasing Act and the OCS Lands Act, the Secretary had to make two separate determinations. To sell onshore oil, he had to find that sufficient supplies of crude oil were not available in the open market to refineries not having their own source of supply for crude oil. The offshore oil sales had to be preceded by a finding that small refiners lacked access to adequate supplies of crude oil at equitable prices. Neither law, nor their legislative histories, specify how these determinations are to be made, nor do they define key terms, such as "sufficient," "adequate," or "equitable." Thus, it was left to the Secretary to make these interpretations. The sales were announced in July 1983, and the

Secretary made the required determinations in the August 1, 1983, Federal Register. The announcement, which covered both OCS and onshore determinations, stated that:

> "This determination of unavailability is based on the following facts:
>
> 1. Small refiners as a class continue to have severe difficulties obtaining long-term commitments from major and independent producers for the proper mix of crude stock to operate their refineries. This has been substantiated by an outpouring of interest in the program and an indication of dire negative effect upon small refiners as a class if the program were to cease.
>
> 2. While the spot availability of surplus crude has increased since the last royalty oil offering in 1980, that surplus does not meet the continuing needs of small refiners as a class for a constant supply of crude stocks of specific types necessary to economically and profitably operate refineries with a pre-planned slate of refined oil products. The availability of crude oil both offshore and onshore continues to be a problem with small refiners as a class."

To obtain further explanation of the rationale for the sales, in May 1984 we formally requested the MMS Director to provide any documentation supporting or clarifying the determination and the criteria used. His reply (see app. IV) made it clear that Interior views the royalty oil program as a necessary and permanent form of assistance to the small refining industry. According to the Director's response, the program is a needed and permanent underpinning for a viable, independent refining industry. Because of their inability to obtain enough supplies of crude oil at prices low enough to allow them to compete, small and independent refiners have not been competitively viable, the Director asserted, except when provided special government assistance. As factors in the determination, the Director cited

--refiner indication of need,

--indications that crude oil was not available to eligible refiners, and

--consideration of market factors affecting crude supply.

The response further stated that before the first serious oil disruption in 1973, the traditional markets for small and independent refiners were bulk sales to government and no-frills, self-service gasoline stations. Over the last 10 years, however, these markets have been heavily invaded by major integrated oil companies with their own refinery operations. According to the

Director, MMS, since 1981 the number of small refiner bankruptcies and closings has increased dramatically, as has the number of small refiners who use royalty oil as a sole or major source of crude oil. For these reasons, MMS believes that the small and independent refiners' need for long-term supplies of crude oil at reasonable prices has become more important than ever and that the royalty oil program is "the only thing that is keeping the small refiner industry alive."

Three separate sales were held in 1983, offering an estimated total 170,000 b/d. A total of 63 refineries were allocated oil, but only 98,000 b/d were contracted for by 48 refineries owned by 46 refiners. Fifteen refineries did not take any oil, and 16 took less than their allocation, generally citing either an inability to exchange the royalty oil for oil closer to their refineries, or the prohibitive cost of (or inability to obtain) surety. (See app. VI.)

MMS did not perform any studies or other analysis quantifying the refiners' needs or crude oil availability. Due to the lack of documentation from MMS substantiating their determination of need and the difficulty of developing such information, we relied heavily on information from the small refiners as to why refiners did, or did not, participate in the program.

From interviews in 1984 with 28 small refiners that applied for royalty oil, 22 of which contracted for oil, we learned that for nearly all, the ability to obtain crude oil at the same price paid by the major integrated oil companies with whom these small refiners must compete is the most important feature of the program. One refiner explained that the major companies and most of the independent producers of crude oil were not selling oil at market prices, but were asking $2 to $3 a barrel more as a bonus. They said the price of royalty oil allowed them to compete with the major refiners. And because royalty oil is sold by long-term contract of a year or more, as opposed to spot purchases on the open market, refiners are assured of having supplies of oil that are not subject to disruption; most of the small refiners we talked to cited reliability as the second most important feature of royalty oil.

We did, however, find that most small refiners obtain only a small portion of their refinery input in the form of royalty oil. Of the 45 refiners who contracted for royalty oil in 1983, only 2 contracted for oil in amounts that represented more than half of their operating capacity. On the other hand, 27, or 60 percent, purchased amounts that made up less than 15 percent of their operating capacity. It should be noted, however, that refineries have been operating at well below capacity. We calculated, using Department of Energy and Oil and Gas Journal data, that those with a capacity of 45,000 b/d or less operated on average at about 57 percent of their capacity in 1983, while larger refineries

operated at about 70 percent capacity on average. Thus, royalty oil would represent a larger proportion of the oil actually refined than it would capacity.

While it may not be a major source of supply for many small refiners, and the number of refiners in the program has declined in recent years, royalty oil may be a critical source for some companies, allowing them to stay in business or re-open. One refiner we interviewed said that royalty oil provides more than half of his refinery's crude oil supply, and that without it, he would not have been able to stay in business for the last 18 years. Another refiner explained that even though royalty oil accounts for only 10 percent of his supplies, the cost of replacing it would be prohibitive and would, therefore, mean operating at much lower capacity and efficiency. Three closed refiners we interviewed had applied for royalty oil in 1983 because they believed its relatively low cost and reliability as a supply source would make it easier for them to obtain financing and customers and thus resume operations.

Even with an increase in the amount of oil offered in 1983, the demand for royalty oil far exceeded supply in the last four sales. In the 1982 interim sale of onshore oil, MMS officials said that refiners requested 17 times the amount of oil offered. As noted earlier, the 1983 sales also offered refiners only a portion of what they asked for, as shown below:

| Sale | B/d offered | B/d requested |
|---|---|---|
| 1983-1 | 137,534 | 479,380 |
| 1983-2 | 8,156 | 601,320 |
| 1983-3 | 25,250 | 226,300 |

Since Interior does not keep statistics on the extent to which refiners own their sources of crude oil supplies, it is impossible to say how many refiners might have been eligible for onshore oil. The number of refiners potentially eligible for offshore oil are those that have refining capacities of 45,000 b/d or less and are not owned by major oil companies. We estimated, on the basis of Department of Energy and Oil and Gas Journal data, that there were 183 refineries of this size in the United States in 1983 (out of a total of 315--see app. III), but 39 of them were also reported or found by us to be inactive, leaving an estimated 144 active eligible refineries at the time of our review.

## CURRENT NEED FOR THE PROGRAM

By late 1984 several refiners had cancelled their contracts. A frequent reason cited to us was that crude oil was becoming available at more favorable prices than royalty oil. By early

1985, the original 45 refiners contracting for oil had declined to 28, and only 46,000 b/d was still under contract, as compared to the 97,000 b/d initially contracted for.

Based on discussions with MMS officials and a number of refinery spokespersons, we found that most of the decline in participation involved Gulf of Mexico offshore oil. The participating refiners' demand for onshore oil and California offshore oil remains strong. Thus, although a national determination of need may not be appropriate at this time, the program still appears to be important to some west coast refiners and other refiners not having ready access to Gulf of Mexico oil.

Proposed termination of the program

In its fiscal year 1986 budget proposal, MMS proposed phasing down and eventually terminating the program. Proposed legislation was also included in the budget providing that the federal government would no longer take oil and gas royalties in kind except on declaration of a national emergency, in effect terminating the program.

Interior's budget proposal cited the continuing cost of the program, litigation that has ensued,[1] declining refiner participation, and the prevailing and expected conditions in the petroleum market. MMS' Associate Director for Royalty Management said he would find it difficult today to justify a need for the program on a national basis. He agreed, however, that nothing precludes MMS from making a determination on a regional rather than national basis.

Current value of the program

Although participation is down, the program apparently is still wanted, particularly by west coast and Rocky Mountain area refiners. Most of the remaining participants are in these areas, and most of the contracts dropped have been for Gulf of Mexico oil.

By February 1985, 24 refiners had dropped all or part of the royalty oil contracted for, representing total daily allotments of 51,570 b/d. Seventeen of the 24 refiners dropped all of their oil contracts. Most of the oil dropped was offshore oil--45,237 b/d. Onshore oil amounting to 6,333 b/d was dropped. In the 1983 royalty oil sale there were 26 west coast refiners that received an

[1]We were advised by Interior's Solicitor's Office that several lawsuits are pending involving the propriety of the 1/2 percent administrative fee and the proper pricing of royalty oil when price controls were in effect.

allocation of oil, and 23 of the 26 refiners actually contracted for oil. Currently 21 of those 23 refiners continue to contract for oil.

The following table shows how the west coast and, to a lesser degree, the Rocky Mountain refiners, have tended to stay in the program, with 95 percent of the oil still under contract being sold to refiners in those areas. Most of the oil dropped has been OCS oil, and most of the OCS oil still under contract is west coast oil.

Royalty Oil Sales Data
1983

| | Number of Refiners | Onshore | Offshore | Total |
|---|---|---|---|---|
| | | b/d | | |
| Originally allocated: | | | | |
| West coast area[a] refiners | 26 | 5,932 | 59,253 | 65,185 |
| Gulf area[b] refiners | 19 | 927 | 45,911 | 46,838 |
| Rocky Mountain area[c] refiners | 11 | 24,237 | 15,935 | 40,172 |
| Other area[d] refiners | 5 | 0 | 16,435 | 16,435 |
| Total | 59[e] | 31,096 | 137,534 | 168,630 |
| Originally contracted: | | | | |
| West coast | 23 | 5,248 | 24,794 | 30,042 |
| Gulf | 12 | 618 | 26,805 | 27,423 |
| Rocky Mountain | 9 | 20,604 | 9,593 | 30,197 |
| Other | 3 | 0 | 9,961 | 9,961 |
| Total | 45[e] | 26,470 | 71,153 | 97,623 |
| Under contract, 2/12/85: | | | | |
| West coast | 21 | 4,564 | 20,929 | 25,493 |
| Gulf | 2 | 309 | 2,000 | 2,309 |
| Rocky Mountain | 6 | 15,264 | 2,987 | 18,251 |
| Other | 0 | 0 | 0 | 0 |
| Total | 28[e] | 20,137 | 25,916 | 46,053 |

[a]California and Washington.
[b]Alabama, Arkansas, Georgia, Louisiana, Mississippi, Oklahoma, and Texas.
[c]Colorado, Montana, Nevada, New Mexico, Utah, and Wyoming.
[d]Indiana, Michigan, and New Jersey.
[e]Totals do not add because of refiners having participating refineries in more than one geographic area.

Source: GAO analysis of MMS contract data.

Of the 24 refiners dropping oil, 17 dropped offshore oil (2 of the 17 also dropped onshore oil) and 6 other refiners dropped onshore oil contracts. We were able to obtain from all but one, their reasons for dropping the oil:

| Refiners dropping offshore oil | Reason |
|---|---|
| 11 | Cheaper oil became available. |
| 2 | Bankruptcy. |
| 2 | Refinery closed. |
| 1 | Exchange agreement became too costly. |
| 1 | Multiple reasons. |
| Total 17[a] | |

| Refiners dropping onshore oil | Reason |
|---|---|
| 3 | Cheaper oil became available. |
| 1 | Bankruptcy. |
| 2 | Exchange agreement and/or gathering and transportation costs became too expensive. |
| 1 | Found to be ineligible for program. |
| 1 | In process of selling refinery. Dropping oil would make it easier to sell the refinery. |
| Total 8 | |

[a]Includes two refiners that also dropped onshore oil.

Of the 24 refiners dropping some oil, 13 told us the main reason was because the royalty oil was too expensive. During the time that refiners were dropping the Gulf of Mexico royalty oil, an MMS official told us that spot-market oil was costing $3 to $4 a barrel less than royalty oil. The refiners we spoke to were unable to say why the prices at which royalty oil sells at were not lower. However, they did speculate that major oil companies do not change prices very readily for several reasons, including, among others, possible effects on oil reserve valuations and tax considerations.

We talked to 20 of the 21 west coast refiners still in the program, 18 of whom said favorably priced oil is still scarce in the west coast market. They pointed out that, for the most part, the California pipelines are owned or controlled by the major oil companies and are not common carrier pipelines, which makes it more difficult for small refiners to purchase oil from independent producers: oil has to be traded. Also, one refiner pointed out that the major oil companies are not in the business of selling crude and need the oil themselves. In addition to difficulty in purchasing oil, one refiner noted that small refiners would prefer to purchase oil from major companies because of the cost of obtaining oil from leases directly. To illustrate the point, the refiner said it currently is purchasing oil from about 200 leases and, to do this, has entered into 80 contracts. It is much easier for the small refiner to purchase oil from a major oil company under one or two contracts and to avoid accounting problems created by not purchasing from major oil companies.

Of the 28 refiners currently purchasing royalty oil, 24 said that favorable prices and/or a stable long-term supply was the reason that they continued to purchase royalty oil. Of the other two refiners providing reasons, one said that the royalty oil was the only source that provided the kind of oil it needs, and the other refiner said that dropping the oil and replacing it would be difficult because its credit line would be "tied-up" until MMS released the letters of credit.

We did find, however, that for the remaining participants, royalty oil provides many of them a relatively small percentage of the amount actually refined:

Royalty Oil as a Percentage of Total Oil Refined

| | Refiners | Percent of refiners oil coming from royalty oil |
|---|---|---|
| | 18 | 10 or less |
| | 1 | 11 to 20 |
| | 3 | 21 to 30 |
| | 1 | 31 to 40 |
| | 2 | 41 to 50 |
| | 1 | Over 51 |
| | 2 | Not obtained |
| Total | 28 | |

Even with the small amount provided, the refiners still perceive royalty oil as a critical source of oil. Of the 28 refiners still participating, 14 stated that they would like to be operating at higher levels, citing high crude prices and/or oil unavailability as the reasons that they are not.

# CHAPTER 3

# POSSIBLE MODIFICATIONS FOR ADMINISTERING

# THE ROYALTY OIL PROGRAM

If the royalty oil program is continued, we believe certain changes can be made to improve its effectiveness. These, along with possible alternatives to the program, are discussed below.

## PROGRAM IMPROVEMENTS

Certain actions could be taken to improve the royalty oil program from a management and/or effectiveness perspective, including

--making a determination of need on a regional basis,

--standardizing the refiner eligibility criteria,

--making the oil that has not been contracted for available to those who may need it,

--recovering the cost of administering the program,

--assuring that the optimal amounts of oil are made available, and

--exploring ways to reduce refiners' surety costs.

### Regional versus nationwide determination of need

Most of the remaining royalty oil program participants are located in the Rocky Mountain and west coast areas. We were advised by Interior's Associate Director of Royalty Management that determinations of need for the royalty oil program have in the past been made on a nationwide basis but that such a determination would be hard to justify today. However, he acknowledged that the authorizing legislation does not preclude a regional determination of need.

The Mineral Leasing Act (30 U.S.C. 192) provides, for sales of onshore royalty oil, that

> ". . . inasmuch as the public interest will be served by the sale of royalty oil to refineries not having their own source of supply for crude oil, the Secretary of the Interior, when he determines that sufficient supplies of crude oil are not available in the open market to such refineries, is authorized and directed to grant preference to such refineries in the sale of oil under the provisions of this section, for processing or use in such refineries . . . ."

Likewise the OCS Lands Act provides that if the Secretary determines that small refiners do not have access to adequate supplies of oil at equitable prices, he may dispose of federal royalty oil by conducting a lottery for the sale of such oil or may equitably allocate the royalty oil among the competitors for the oil.

Thus, there are no stated criteria in either law as to the number of refiners in need or other factors that must be met before royalty oil sales can be made to small or independent refiners; the basis for a determination of need is left largely to the Secretary of the Interior's discretion. If the Secretary believes the situation in the western United States warrants the sale of federal royalty oil to eligible refiners, sales, in our opinion, could be held based on a regional determination of need.

## Different criteria for refiner eligibility makes program management more difficult

As noted earlier, the Mineral Leasing Act and the OCS Lands Act, while sharing an intent to aid refiners, nevertheless define their intended beneficiaries differently. The OCS Act defines small refiners in terms of size, as measured by the Small Business Administration. The current SBA standard sets small refinery capacity at 45,000 b/d or less and number of employees at no more than 1,500 people. The Mineral Leasing Act, in contrast, refers only to refiners not having their own source of crude oil supply. While the legislative histories of these acts do not show why these legal distinctions were made, the difference requires that MMS have a dual regulatory system and separate policies for onshore and offshore royalty oil sales. According to MMS, these differences in the criteria established by the two leasing laws make program administration more difficult. Perhaps more importantly, they create inconsistency and uncertainty as to which refiners are to benefit from the program.

This distinction is a relatively recent one. In 1960, Interior began to use the SBA standard as its criteria for eligibility for onshore royalty oil and, in 1969, amended its regulations to reflect this change in practice. The same standard was used for the first OCS sale in 1972, and the 1978 OCS Act amendments incorporated it into law. However, a court decision in 1979 eliminated the use of a size standard for refiners applying for onshore oil. In _Plateau, Inc._ v. _Department of the Interior_, the appeals court ruled that the Mineral Leasing Act defined its beneficiaries as those refineries without their own source of crude oil; the Secretary could not, therefore, restrict sale of onshore oil to small refiners as defined by SBA.

Since the _Plateau_ decision, Interior has considered and used several different criteria for eligibility for onshore oil, but it has not yet revised its regulations. For its 1980 sales, it defined an eligible refiner as one who could demonstrate an inability to obtain an adequate supply of crude oil to meet its

existing capacity. In the 1982 interim sale, use of this definition allowed at least one major oil company, Texaco, Inc., to buy royalty oil.

For the 1983 sales, MMS limited participation in the onshore program to those refiners who met the definition of an independent refiner set forth in the Emergency Petroleum Allocation Act. To be eligible, a refiner had to obtain more than 70 percent of its refinery input, in the calendar quarter that ended immediately prior to the date of enactment of the act, from sources it did not own or control. Refiners also had to have distributed in such quarter and, subsequently, a substantial volume of their refined gasoline through independent marketers. These criteria were part of MMS' proposed permanent regulations.

According to this latest standard, need is measured as a function of ownership of crude oil supply sources; the level at which a refinery is operating is no longer considered an indicator of need. In fact, because the current standard is based on refinery input, it can have the effect of penalizing refiners with low production levels. For example, one small refiner who applied for onshore oil in 1983 was found ineligible because he owned the source of 35 percent of the oil that had gone into his refinery, which was operating at 61.6 percent of capacity. If the refinery had been operating at 100 percent capacity, the same oil supplies would have made up only 21.8 percent of input, and the refiner would have been eligible to receive an allotment. Seven of the 14 refiners who owned oil supply sources small enough to allow them to buy onshore royalty oil were operating at capacities higher than the refiner found ineligible, one of them at 100 percent. (See app. V.)

The difference in eligibility criteria for onshore and offshore oil has created two separate categories of refiners that can purchase royalty oil. Seven refiners who were able to purchase onshore oil in 1983, for example, would not have been able to buy offshore oil because their capacities exceeded 45,000 b/d. Most of them, with total capacities of about 100,000 b/d, are still far from the size of major oil company refining operations, which are about 1 million b/d in total. By the same token, at least two refiners that met the size criteria for offshore oil were not eligible to buy onshore oil because they owned too large a share of the source of their refinery input. For those eligible to purchase only onshore oil, however, the amount of onshore oil available is much less than offshore sources.

According to MMS, these differences in eligibility criteria make program administration difficult. In 1982, an agency task force examined problems in the administration of the royalty oil

program. Its report[1] stated that the split in refiner eligibility criteria fragments operational policies and objectives and causes regulatory administrative problems. For example, separate sales and announcements are required and two sets of regulations are used. Also, as discussed above, Interior's attempts to correct the differences has resulted in litigation. The report recommended either continuing with two eligibility criteria or adapting 175,000 b/d as the standard for both onshore and offshore, subject to an Interior legal opinion.

## Much of the royalty oil is turned back and not offered until the next sale

Of the 168,630 barrels of oil a day allotted to refiners at the 1983 sales, considerable quantities were turned back to MMS. By March 1984, when the contracts were signed, only about 98,000 b/d, or 58 percent, was sold. However, MMS does not reoffer the unsold oil until its next scheduled sales, even though other refiners might have a need for it.

The fact that the oil was not contracted for does not indicate a lack of demand for it. Based on our discussions with them, about one-half of the 31 refiners who turned back all or part of their allotments did so because they were unable to work out arrangements for trading their allotments for other oil that was closer to their refineries or of a more suitable quality. We were told that almost one-quarter (7) of the refiners could not purchase their allotted oil because they were not able to obtain surety. (See p. 23 for further discussion of the surety problem.) Six other refiners turned back oil for multiple reasons, including bankruptcy.

A couple of changes were under consideration by MMS to reduce the number of instances in which oil is turned back for these reasons. For future royalty oil sales, MMS had planned to require applicants to demonstrate their ability to obtain the required surety, in the form of a stated intent to provide surety from a financial institution, before they could receive an allotment. In addition, MMS had planned to give west coast refiners preference in the selection of Pacific leases, hoping to reduce the amount of oil that is turned back for lack of exchange agreements.

MMS has been reluctant to reoffer the oil not contracted for because of the administrative burden in preparing for and holding a sale. However, we believe MMS could avoid holding another sale by stating in the original Federal Register announcement that oil turned back after the sale will be reallocated to the remaining qualified participants. MMS' Associate Director for Royalty Management agreed that this could be done and would be appropriate.

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[1] RIK Task Force Report of Recommendations for Improvements in Administration of Royalty In-Kind Program, Jan. 12, 1983.

## Recouping the costs of administering the royalty oil program

The government sells royalty oil for the same amount it would have received had it taken its royalties in cash. However, Interior incurs some costs (primarily employee salaries) for planning and holding the sale, and administering the program. We were advised that Interior's fiscal year 1984 cost for the royalty oil program was $570,000, but such costs will be reduced as Interior proceeds with its plans to have the refiners pay the administrative costs.

Under the Independent Offices Appropriations Act of 1952 (31 U.S.C. 9701), government agencies are authorized to impose user fees for certain goods and services. Interior, in turn, has an established policy of recovering agencies' costs to perform specific services. USGS used to charge refiners an administrative fee of 0.5 percent of their contract amount. However, in 1981, Interior's Solicitor's Office ruled that its fee for the OCS program had to be, but was not, based on costs. MMS dropped the fee altogether for the 1983 royalty oil sales. Recently, however, at the urging of OMB, MMS changed its accounting system and developed cost centers, which will enable it to re-impose a fee on future sale contracts (if additional sales are held) to recover its administrative costs. A portion of these costs are already being recovered. For those offshore sales contracts extended from July through December 1985, MMS is charging the refiner an administrative fee of $150 per lease per month. This, due to the small number of OCS leases still in the program, will result in the collection of only about $9,000 in fiscal year 1985. However, as other contracts are extended or let, they will also be assessed the fee, which, according to MMS, will increase the cost of the oil to the refiners a few cents a barrel.

## Possible increased onshore offerings

Interior plans to screen about 15,000 producing onshore leases to assure that it is offering the most oil reasonably possible if future sales under the program are held. As a matter of expediency, MMS in the 1983 sale offered oil from the same leases it used in the 1980 sale. Thus, any newly producing onshore leases were not included in the 1983 sale. Although it is not known how much additional oil this would provide, MMS plans to screen all onshore leases for any future sales. We believe this should be done, particularly since small and independent refiner demand for onshore oil remains high; most of the turned-back oil has been Gulf Coast OCS oil.

### High surety requirements and related billing/delivery problems

Currently, MMS requires refiners to pay higher up-front costs than are required by industry standards. MMS requires refiners to provide surety in an amount equal to the value of 90 days of deliveries, in contrast to the industry standard of 60 days. Refiners must also make two payments to MMS for the oil they receive during the first month of their contracts, one for the estimated amount and the other for the actual amount of oil they should have received. The estimated payment is held until the end of the contract as a kind of deposit, when it either is applied toward any amount owed by the refiner or refunded.

Seventeen of the refiners we interviewed complained that the 90-day surety requirement was burdensome and excessive. One refinery that did not apply for royalty oil said that it did not apply because of the high surety requirements, and another refiner said the high surety rate played a role in the decision. MMS also requires that letters of credit be kept for 180 days after the contracts end, to allow MMS time to reconcile billings and deliveries. Two refiners said that this requirement was an unproductive limit on the refiners' line of credit. Moreover, 7 of the 31 refiners who turned back oil at the 1983 sales said they did so because they could not meet the surety requirements.

MMS officials explained that the first refiner billing, based on estimated royalties, allows them to begin collecting for royalty oil at the same time as other royalties. The officials also said that the 90-day surety was necessary to protect the government's interest because a refiner could receive up to 90 days of oil deliveries without making any payments because of the time lag between deliveries and MMS' receipt of production and preparation and mailing of the bill. MMS is still trying to collect unpaid portions of $943,198 in bad debts arising from the 1980 sale. The officials went on to explain that letters of credit remain open for 180 days because that time may be needed to reconcile deliveries with billings. If circumstances permit, they said, letters of credit are released sooner.

#### Oil deliveries based on estimates

The amount of oil a refinery is entitled to is based on actual production for the entire month, but deliveries are made during the month, creating the possibility of an under- or over-delivery.

Lease operators we interviewed said that they are subject to losses if a refiner cancels its contract with MMS before they have had a chance to adjust for over-deliveries or deliveries of oil of better quality. These situations can occur when refiners are entitled to only a small amount of royalty oil, but the operator

has to ship more to meet minimum shipment requirements of certain pipelines or when operators have arranged for deliveries on the basis of production estimates that were overstated. The oil delivered to a refiner may also be of higher quality than the oil the refiner is entitled to because the oil is commingled with other grades of oil in the pipeline.

Normally, any errors in a monthly shipment are adjusted in following months. However, if the refiner cancels its contract with MMS before the operator has made its adjustment, the operator may not be able to collect on the amount of over-deliveries. If a refiner declares bankruptcy, operators have no contract on which to base a claim. One major oil company claimed to have lost $1.7 million in oil deliveries to two refiners that went out of business or declared bankruptcy.

Another way to eliminate this risk is for lease operators to obtain surety from the refiner, a practice MMS officials told us some operators are following. However, MMS is currently looking into the legality of this practice because, under the current system, oil sales contracts are between refiners and MMS; the lease operators and refiners have no contractual relationship on which to base a surety requirement.

MMS officials suggested that one possible procedural change, which would reduce surety requirements as well as the billing and delivery problems, is to begin delivery of royalty oil in the month following production so that billings can be based on actual rather then expected royalty values.

## ALTERNATIVES TO THE ROYALTY OIL PROGRAM

We identified two other cases in which federally controlled oil is sold to small refiners--sales to small refiners of 20 percent of the production from recent offshore leases, as required by the 1978 amendments to the OCS Lands Act, and sales of oil from the Naval Petroleum Reserves. Neither could currently serve as a substitute for the royalty oil program, since they are already providing oil to the small refiners. However, the sale of 20 percent of offshore production may have long-range potential as additional new leases come into production.

### Direct sales of offshore oil to small refiners

Section 8 of the Outer Continental Shelf Lands Act, as amended, provides that all lease holders must offer 20 percent of the crude oil they produce to small refiners. Since this set-aside provision applies only to leases issued since 1978,

it does not include many of the producing offshore leases. None of the Pacific lease operators, for example, are required to sell their oil to small refiners, either because their leases pre-date the act, or because their leases are not yet producing. In the Gulf of Mexico, only 63 leases operated by 27 operators contain this provision. Since these leases produce a total of 41,500 b/d, only 8,300 b/d are specifically intended for small refiners. However, the MMS official in charge of the royalty oil program expects that greater quantities of oil will be available in future years, as more leases come into production, and said he hopes that these sales may eventually replace the royalty oil program.

Set Aside Of Naval
Petroleum Reserve Oil

The Naval Petroleum Reserves Act of 1976 (10 U.S.C. 7430(d)) authorizes the Secretary of Energy to set aside up to 25 percent of the government's share of oil produced on the naval petroleum reserves for sale to small refiners, as defined by the Small Business Adminstration. The act requires that the Secretary must determine that such a sale serves the public interest by making oil available to small refiners not having their own adequate sources of crude oil supply. DOE conducts no formal analysis, however, relying instead on continual monitoring of the crude oil market.

The act specifies that all oil produced on the reserves must be sold to the highest qualified bidders. The Secretary may waive this provision for small refiners and prorate the oil among them for sale at not less than the market, or posted, price. Although DOE has sold reserve oil in this way, the most recent sales have been marked by competition among both large and small companies.

Since 1983 DOE has implemented a small refiner preference, rather than set-aside, program. In previous sales, 25 percent of the oil was set aside for sale to small refiners, and they bid only against each other for the purchase of this oil. They could also enter bids to purchase portions of the remaining 75 percent. Now, however, all companies, regardless of size, compete against each other. If DOE finds, after reviewing bids, that small refiners have submitted winning bids for less than 25 percent of the oil offered, it asks the small refiners with the highest unacceptable bids if they are willing to meet the bids submitted by the larger, winning companies. In this way, DOE displaces larger companies with small refiners until the 25-percent goal is met.

According to Interior, OMB was advocating competitive sales of royalty oil prior to the current proposal to terminate the program. While competitive oil sales hold forth the possibility of increased revenues to the government, particularly in times of high demand for oil, it is not clear that such sales would be desirable or consistent with the purpose of the program, which is to assist refiners without a source of supply for crude oil, not

simply those most able to afford to buy the oil. Competitive oil sales would increase oil costs to small refiners and would not ensure that all eligible refiners receive an allotment of oil.

## CHAPTER 4

## CONCLUSIONS AND OBSERVATIONS

MMS did not perform any studies or other analyses for the 1983 sales quantifying the refiners' needs or crude oil availability. Although Interior did not conduct such analyses, the law does not require it. Interior's determination met the requirements of the authorizing legislation.

In early 1984 there were 45 refiners receiving a total of nearly 100,000 b/d of royalty oil. As the year progressed, however, the crude oil market softened. Many refiners--particularly those obtaining royalty oil from leases in the Gulf of Mexico--found it possible and more advantageous (that is, cheaper) to obtain crude oil elsewhere. Several refiners said they withdrew from the program for that reason; others withdrew because they still were having financial difficulties and had to close their refineries. This situation culminated in early 1985 with Interior's announced intention to terminate the program, as well as to seek legislation that would in effect abolish the program. However, a notable exception to the easing of the crude situation was the west coast and Rocky Mountain areas, where some small and independent refiners are still anxious to participate in the program. Onshore oil in general, located primarily in the west, remains in high demand.

The number of refiners participating in the royalty oil program is down considerably, and in recent months the decline can be attributed to a lessening need for royalty oil by small or independent refiners. Further, the program does not appear to represent a major source of oil for most of the remaining participants, and it is difficult to substantiate the relative importance of royalty oil to them. On the other hand, those remaining participants find the program of value and consider its continuation important. This seems to be particularly true in the Rocky Mountain and west coast areas where 26 of the remaining 28 participants, which are purchasing 95 percent of the 46,000 b/d still under contract, are located. Twenty-four of these refiners said they are still anxious to participate in the program--mainly because of (1) the difficulty in obtaining crude oil from major producers and (2) their remoteness from the Gulf Coast where the bulk of the oil "glut" exists.

Although the need for the program now appears to be limited to a small number of refiners--primarily those in the western United States--changes in oil prices and availability could increase refiners' need for the program. Further, Interior was in the process of instituting a fee to recover the costs of administering the program. Thus, although it is unclear whether royalty oil sales are warranted at this time, we see no compelling reason to legislatively restrict Interior from using the program in the future if it remains Congress' desire to aid the small and

independent refiner, and if Interior determines that refiners have a need for the oil now or in the future.

If the program does continue, and if the Secretary finds that a determination of need for royalty oil sales is appropriate, we believe that he should consider several ideas which could improve its effectiveness. These include

--considering whether a determination of need on a regional rather than national basis would be desirable;

--determining what group of refiners should benefit from the program and seek legislation to establish consistent eligibility criteria for both onshore and offshore oil;

--providing in future sales announcements that oil not contracted for will be equitably allocated among eligible participants;

--continuing plans to determine if additional onshore leases warrant inclusion in the program;

--continuing with ongoing actions to charge participants a fee to recoup the costs of administering the program; and

--exploring ways by which refiners' surety expenses might be reduced without undesirable financial risk or expense to the government.

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U.S. House of Representatives
Subcommittee on Oversight and Investigations
of the
Committee on Energy and Commerce
Washington, D.C. 20515

August 8, 1983

Honorable Charles A. Bowsher
Comptroller
General Accounting Office
441 G Street, N. W.
Washington, D. C. 20548

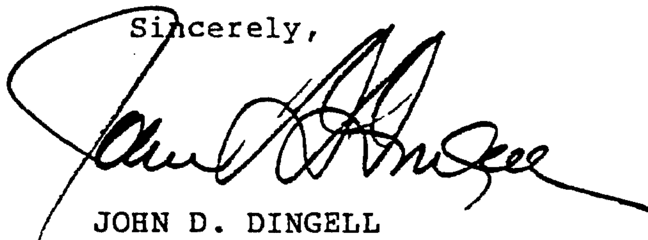
Dear Mr. Bowsher:

The Federal Register of August 1, 1983 includes a "Notice of Determination of Unavailability of Oil to Small Refiners and Declaration of Intent to Proceed with Sale of Royalty Oil by the Secretary of the Interior" (48 F.R. 34811).

I request that your agency examine this determination and declaration, including the basis for determining that small refiners do not have access to adequate supplies of crude oil at equitable prices. Please include an examination of prior determinations and sales and the process followed by the agency in reaching these conclusions, including the consideration of alternatives.

As usual, please do not obtain agency review of your report. Please keep my staff informed of your progress.

Sincerely,



JOHN D. DINGELL
Chairman
Subcommittee on
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## ROYALTY OIL SALES

## 1980-1983

As with the 1983 sales, Interior's previous determinations of need for royalty oil rested heavily on small refiners' expressions of interest. Before the 1980 sale, refiner interest and need for onshore oil were conveyed to district or area oil and gas supervisors of the U.S. Geological Survey (USGS), the agency then in charge of the program. If a supervisor found that royalty oil would be available in his area, he notified small refiners in his area and those outside who he expected would be interested. Those that wanted to obtain royalty oil had to demonstrate a need for it by showing that they could not meet their total refining capacity through a combination of their own supplies and those available on the open market. As evidence of these shortages, companies were required to submit records of production runs in the previous 12 months. This information, along with the supervisor's determination, was sent to Interior and subsequently served as the basis for the Secretary's formal determination.

### 1980 ROYALTY OIL SALES

On January 14, 1980, the USGS announced in the Federal Register its intent to sell royalty oil for onshore and offshore federal leases to small refiners.

### Onshore oil sales

Using its authority to grant refiners a preference to oil produced in the area in which the refineries were located, USGS held sales of onshore oil at six of its area offices across the country in March 1980. The amounts offered ranged from 180 b/d (the eastern area office) to 30,000 b/d (the northern Rocky Mountain area), totaling 43,190 b/d. Refiners were offered 3-year contracts beginning June 1, 1980.

### Offshore oil sale

USGS' sale of offshore oil was held in April 1980, with an offering of 4,550 b/d from leases in the Pacific Ocean and 93,183 b/d of Gulf of Mexico oil. Thirty-five refiners applied for Pacific oil and 114 for Gulf oil; 90 attended the sale. A lottery was held to determine the order in which refiners would select their oil. USGS also announced that refiners' allotments would be limited by the quantities of onshore oil they had received, that is, refiners' combined purchases of onshore and offshore oil could not exceed either the base allocation for the offshore sale or 60 percent of the refiners' total capacity. In addition, refiners who had not purchased any onshore oil were to receive preference in purchasing offshore oil. The largest allotment made was for 1,107 b/d. Contracts were also for 3 years, beginning July 1, 1980.

## 1982 INTERIM SALE OF ONSHORE ROYALTY OIL

In an August 23, 1982, Federal Register notice, the Minerals Management Service (MMS) sought expressions of interest from refiners in a sale of onshore royalty oil turned back by refiners who had cancelled their 1980 contracts.

A sale was held in October 1982, in which twenty refiners applied and 10 were awarded contracts, including Texaco, Inc. A total of 21,925 b/d was sold from leases in the southern Rocky Mountain, northern Rocky Mountain, and Pacific areas.

## 1983 ROYALTY OIL SALES

Interior's three 1983 sales were originally announced in April 1983; sales were withdrawn to reschedule the sales dates, and then reannounced in July 1983. The Federal Register notice provided application deadlines, sales dates, refiner eligibility criteria, and the approximate amounts and general locations of oil to be offered at each sale.

### Onshore royalty oil sales

Onshore oil was sold at two sales: Sale No. 83-2, held in November 1983, for royalty oil from leases in the western and south central United States, and Sale No. 83-3, held in December, for oil from leases in northern, central, and eastern states.

Out of 59 refineries that applied for Sale No. 83-2, MMS rejected 14 applications because they were not in the western or south central states; 5 applications were rejected because MMS allows only one application in a sale from affiliated companies. The 40 eligible refiners requested a total of 567,320 b/d. Using a lottery to allocate the available royalty oil, MMS allotted 8,156 b/d among the 34 refiners who attended the sale: 27 received western area oil in equal portions of about 228 b/d each, and south central area oil was divided among 7 refiners, generally in shares of 309 b/d each.

For Sale No. 83-3, MMS offered 25,250 b/d from 227 leases in Colorado, Montana, North Dakota, Utah, Louisiana, and Mississippi. However, because none of the applicants for eastern area oil appeared at the sale, that portion was cancelled, and MMS' offering was reduced to 24,795 b/d of only north central oil. Fifty-three refiners applied in total, but 33 were turned down. Most of them--28--did not own refineries in either area; two applications came from companies whose affiliates were also participating in the sale; two companies--Chevron and Shell Oil--did not meet refiner eligibility criteria; and one applicant was still in arrears on an earlier royalty oil contract. The 20 eligible refiners requested 226,300 b/d in total.

Since the requests again exceeded the amount of oil available, MMS divided the available oil in equal shares. One refiner, however, received a smaller share because he requested only 300 barrels. MMS then made a second allocation when one refiner left the sale before its end and another took only 525 barrels of his allocation. In the end, a total of nine 22,940 b/d were allocated among refiners.

Offshore oil sale

At Sale No. 83-1, held in October 1983, a total of 137,534 b/d was offered from Pacific and Gulf of Mexico leases. Sixty-three refiners applied for oil, but 10 applications were rejected--7 because affiliated companies had also applied, 2 because the applicants' total refining capacities exceeded the 45,000 b/d limit, and 1 because the refiner's previous contract payments were in arrears.

Of those whose applications were accepted, 48 attended the sale. They requested a total of 479,380 b/d, more than 3 times the amount of oil offered. To allocate the oil, MMS first divided the amount of oil available by the number of eligible refiners in attendance. Those who requested less than their equal share were allotted their full request, and the unclaimed amount was then divided among the other refiners. In addition, nine refiners received an extra 500 b/d because two refiners withdrew from the sale before selecting leases. In this way, a total of 46 refiners received varying amounts of offshore oil: 9 were allotted 3,487 b/d, 32 received shares of 2,987 b/d, and 5 received lesser amounts.

## DAILY REFINING CAPACITY OF

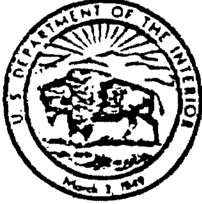
## REFINERIES BY STATE 1983

| State[a] | 45,000 b/d or less | 45,001 to 175,000 b/d | Over 175,000 b/d | Total refineries |
|---|---|---|---|---|
| Alabama | 5 | 1 | 0 | 6 |
| Alaska | 3 | 1 | 0 | 4 |
| Arizona | 1 | 0 | 0 | 1 |
| Arkansas | 3 | 1 | 0 | 4 |
| California | 31 | 13 | 3 | 47 |
| Colorado | 3 | 0 | 0 | 3 |
| Delaware | 0 | 1 | 0 | 1 |
| Florida | 1 | 0 | 0 | 1 |
| Georgia | 2 | 0 | 0 | 2 |
| Hawaii | 0 | 2 | 0 | 2 |
| Illinois | 2 | 4 | 3 | 9 |
| Indiana | 6 | 1 | 1 | 8 |
| Kansas | 6 | 5 | 0 | 11 |
| Kentucky | 4 | 0 | 1 | 5 |
| Louisiana | 20 | 7 | 6 | 33 |
| Maryland | 2 | 0 | 0 | 2 |
| Michigan | 4 | 1 | 0 | 5 |
| Minnesota | 0 | 2 | 0 | 2 |
| Mississippi | 6 | 0 | 1 | 7 |
| Missouri | 0 | 1 | 0 | 1 |
| Montana | 6 | 1 | 0 | 7 |
| Nebraska | 1 | 0 | 0 | 1 |
| Nevada | 1 | 0 | 0 | 1 |
| New Jersey | 1 | 5 | 0 | 6 |
| New Mexico | 7 | 0 | 0 | 7 |
| New York | 1 | 1 | 0 | 2 |
| North Carolina | 1 | 0 | 0 | 1 |
| North Dakota | 2 | 1 | 0 | 3 |
| Ohio | 2 | 4 | 0 | 6 |
| Oklahoma | 7 | 5 | 0 | 12 |
| Oregon | 1 | 0 | 0 | 1 |
| Pennsylvania | 6 | 5 | 0 | 11 |
| Tennessee | 0 | 1 | 0 | 1 |
| Texas | 41 | 18 | 8 | 67 |
| Utah | 8 | 0 | 0 | 8 |
| Virginia | 0 | 1 | 0 | 1 |
| Washington | 4 | 4 | 0 | 8 |
| West Virginia | 3 | 0 | 0 | 3 |
| Wisconsin | 1 | 0 | 0 | 1 |
| Wyoming | 12 | 2 | 0 | 14 |
| Total | 204 | 88 | 23 | 315 |

[a]States not appearing on this list do not have refineries.

Source: Department of Energy and *The Oil and Gas Journal*.

APPENDIX IV



# United States Department of the Interior

MINERALS MANAGEMENT SERVICE
RESTON, VA. 22091

In Reply Refer To:
LMS-Mail Stop 660

JUN 1 1 1984

Mr. F. Kevin Boland
Senior Associate Director
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Boland

This is in response to your letter of May 9, 1984, concerning the GAO examination of the Royalty-in-Kind (RIK) program administered by the Minerals Management Service (MMS).

As we understand your letter, your primary interest is in obtaining from us the rationale for making specific determinations to take Federal Royalty Oil-in-Kind under the provisions of the Minerals Leasing Act and the Outer Continental Shelf (OCS) Lands Act.

Since MMS has assumed responsibility for administering the RIK program, we have attempted to streamline the program in a number of ways, reducing the burden of administration on the Government, reducing red tape for the producers who provide the oil, and enhancing the utility of the program to the small refiner client group who continue to remain heavily dependent on royalty oil for their refining operations.

As part of this streamlining process, we have developed a set of regulations which will be issued shortly as a proposed rulemaking to cover the sale of royalty oil, both offshore and onshore. While the statutory language and the legislative history of the Minerals Leasing Act and the OCS Lands Act differ relative to the Secretary's ability to take oil-in-kind and sell it to refiners, we believe, after careful study of the background and history of the program, that it is and continues to be Congress' intent to make royalty oil available primarily to refiners who (1) are not producers of oil and therefore do not have a steady source of supply under their direct control and (2) have difficulty obtaining "access to adequate supplies of oil at equitable prices." It is our belief that since the program first began, the intent of Congress was to use royalty oil as an underpinning for a viable independent refining industry.

In your letter you asked if MMS has established specific criteria for making the statutory Secretarial determination of the need for making royalty oil available to small and independent refiners. We do not believe

Mr. F. Kevin Boland 2

that specific criteria other than those contained in the statutes themselves are required; the language of the statutes is explicit: it is Congress' intent to make Federal royalty oil available to those refiners who as a class have difficulty effectively competing for crude oil in the open market. Constancy of supply and reasonable price are the criteria, nothing more is needed.

As a recent article in Business Week magazine pointed out, the position of the small independent refiner in the United States has deteriorated rapidly in the last 2 years. The number of small refiner bankruptcies and business cessations has increased dramatically since 1981. While a number of factors have been blamed for this phenomenon, the fact is that except where provided special shelter or protection by the Federal Government, small and independent refiners have never been competitively viable, primarily because of their inability to obtain adequate supplies of crude for their refineries at prices which will allow them to maintain a profitable refining operation in a highly competitive energy market.

To understand the importance of adequate supply at an equitable price, it is important to analyze the market to which small and independent refiners have directed their finished product during the 1960s and early 1970s. Before the first severe oil disruption in 1973, the small and independent refiners' primary market for gasoline products was the independent, non-brand gas stations. In some cases, these refiners owned or leased their own string of gas stations, but normally they sold their gasoline product to independent marketers who were able to sell the product on a no-frills basis. The other product slates coming from these refineries were for the most part sold under contract to local, State, and Federal Government agencies who bought products in bulk on a competitive basis. To deal in these markets required the refiner to develop a steady source of crude at a competitive price.

Over the last 10 years the segment of the market to which the small and independent refiner was geared has changed dramatically. Not only has the no-frills, self-service gasoline market been heavily invaded by major integrated refiners, but these same refiners are heavily involved in Government bulk contracts impacting the market area that once was the sole province of the small refiner. As a result, the need to obtain sustained, adequate supplies of crude on a long-term basis at reasonable prices has become more important than ever to the small and independent refiner. This need has been met to a great extent by the Department of the Interior royalty oil program. It is, in our opinion, the only thing that is keeping the small refiner industry alive. The number of small refiners who utilize royalty oil as a sole or major source of crude for their refineries has increased dramatically over the last 2 years. While the number of refiners involved in the program has been dropping (see below), those who are in the program are more highly dependent on it.

Mr. F. Kevin Boland 3

Further, the adverse conditions under which small and independent refiners must operate, particularly the financial terms and conditions of exchange agreements, have increased dramatically. Also, many of these refiners are burdened with huge debt for capital improvement costs associated with refinery modification or improvement made in the last 5 years to allow them to utilize poorer quality crudes which are more readily available for their operations.

These conditions have taken their toll among the small refining industry; the statistics of small refiners involved in the RIK program clearly indicate the diminishing numbers in this industry class:

| | Refiners Taking Royalty Oil |
|---|---|
| January 1981 | 130 |
| January 1982 | 109 |
| January 1983 | 52 |

In response to the specific questions in your letter concerning the basis for recent royalty sales, we have the following comments:

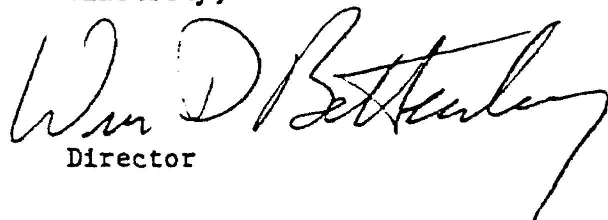
As stated above, we consider the criteria contained in the statutes as the basis for determining the need for continuing the program. Among the indicators MMS has used are: (1) indication of need from the small refiner client group; (2) continuing indications that crude is not readily available to this refiner class; and (3) consideration of market factors affecting crude supply in market areas where small and independent refiners seek crude supplies.

In the past four sales of royalty oil, the demand for oil has far exceeded the supply even after a substantial increase in the availability of royalty oil for the 1983 sales.

We see the RIK program as a permanent underpinning for the small and independent refining industry in this country until and unless Congress, by statute, chooses some other option.

We hope this information is helpful to you in completing your examination of the RIK program.

Sincerely,



Director

## ELIGIBILITY OF THOSE REFINERS PROCESSING OIL FROM SOURCES THEY CONTROLLED

## 1983 SALES

| Refiner | Number of refineries | Daily refining capacity (in barrels) (000's) | Refining capacity Being used (percent) | Refining capacity Satisfied by own oil (percent) | Refinery input satisfied by own oil (percent) |
|---|---|---|---|---|---|
| 1 | 2 | 20 | 81.0 | 6.3 | 7.8 |
| 2 | 1 | 24 | 61.6 | 21.8 | 35.4[a] |
| 3 | 1 | 4 | 47.5 | 30.0 | 63.2[b] |
| 4 | 1 | 44 | 88.3 | 3.3 | 3.7 |
| 5 | 4 | 261 | 68.5 | .9 | 1.4 |
| 6 | 2 | 18 | 54.0 | 1.5 | 2.8 |
| 7 | 1 | 40 | 49.5 | .3 | .6 |
| 8 | 1 | 13 | 65.1 | 11.4 | 17.6 |
| 9 | 1 | 5 | 29.5 | .7 | 2.2 |
| 10 | 1 | 30 | 92.2 | 2.7 | 2.9 |
| 11 | 1 | 36 | 86.9 | 1.3 | 1.5 |
| 12 | 1 | 100 | 100.0 | 3.0 | 3.0 |
| 13 | 2 | 112 | 3.3 | .3 | 9.0 |
| 14 | 2 | 56 | 61.4 | 23.7 | 38.6[b] |
| 15 | 3 | 120 | 53.6 | .7 | 1.3 |

[a]MMS cancelled this refiner's royalty oil contract.

[b]MMS found data reported by refiner were not accurate and that the refiner was eligible to purchase royalty oil. Refiner number 3 was not processing any owned oil. Refiner number 14 was processing only one-half of the amount reported above.

Source: GAO analysis of 1983 royalty oil sale applications of the 15 refiners controlling some of their own oil.

## AMOUNT OF ROYALTY OIL NOT CONTRACTED FOR BY REFINERIES IN THE 1983 ROYALTY OIL SALES AND REASONS WHY IT WAS NOT CONTRACTED[a]

| | Refineries not contracting for | | |
|---|---|---|---|
| | Any of their royalty oil allotment | Part of their royalty oil allotment | Total |
| Number of refineries | 15 | 16 | 31 |
| Amount of royalty oil allotted to the refineries from (in barrels per day): | | | |
| - Offshore leases | 33,357 | 41,344 | 74,701 |
| - Onshore leases | 2,046 | 13,682 | 15,728 |
| Total | 35,403 | 55,026 | 90,429 |
| Amount of royalty oil not contracted for from (in barrels per day): | | | |
| - Offshore leases | 33,357 | 33,022 | 66,379 |
| - Onshore leases | 2,046 | 2,580 | 4,626 |
| Total | 35,403 | 35,602 | 71,005 |
| Reasons refineries did not contract for royalty oil: | | | |
| - Surety too costly or not able to be obtained | 6 | 1 | 7 |
| - Royalty oil was not able to be traded or was not economical to trade | 3 | 13 | 16 |
| - Bankruptcy, expensive transportation costs, and others | 6 | 2 | 8 |
| Total | 15 | 16 | 31 |

[a]Schedule does not include oil that became available because of contract cancellations after March 1984.

(005580)

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