



United States  
General Accounting Office  
Washington, D.C. 20548

Resources, Community, and  
Economic Development Division

B-270191

October 17, 1995

The Honorable John McCain  
United States Senate

Dear Senator McCain:

You asked us to review draft legislation proposing the sale of the six Naval Petroleum and Oil Shale Reserves.<sup>1</sup> This report follows your earlier request that we review draft legislation to sell one of these six reserves, namely, Naval Petroleum Reserve Number 1 (NPR-1).<sup>2</sup> Specifically, you asked us to review the proposed method of sale to determine if it will provide an equal opportunity to all prospective purchasers and will yield the maximum proceeds to the federal government. In addition, you asked for any suggestions that we might have to improve this legislation to ensure that the government receives the best value for these reserves. As requested, we have also included separate comments on each of the two versions of section 7421b of the draft legislation. Because the legislation we reviewed is in draft form and subject to change, our views are preliminary and could change on the basis of the language of the legislation in its final form.

In summary, the method of sale as proposed in the draft legislation, involving the publication of a notice of intent to sell the reserves, appears consistent with efforts to provide equal opportunity to all prospective purchasers. The proposed method of sale--by stipulating acceptance of the highest responsible offer or offers that meet or exceed the minimum acceptable price, which is to be determined after considering, among other things, the net present value that the Department of the Treasury would receive from the reserves if the reserves were not sold--appears consistent with efforts to yield a fair market value to the government.

---

<sup>1</sup>This proposal is to be incorporated in the Fiscal Year 1996 Defense Authorization Act and the Budget Reconciliation Act of 1996.

<sup>2</sup>See Sale of NPR-1 (GAO/RCED-95-255R, Aug. 1, 1995).

155445

BACKGROUND

The Naval Petroleum and Oil Shale Reserves, established in the early 1900s, consist of three petroleum sites in California and Wyoming and three oil shale sites in Colorado and Utah. NPR-1, commonly referred to as Elk Hills, covers 47,409 acres in Kern County, California, and is located about 35 miles west of Bakersfield. It is one of the 10 largest domestic producing oil fields in the lower 48 states and one of the nation's top producing gas fields. The U.S. government owns about 78 percent of the reserve, while Chevron U.S.A. owns the remaining 22 percent. The reserve is managed by the Department of Energy (DOE) and is operated under contract by Bechtel Petroleum Operations, Inc. Currently, both the administration and the Congress are proposing to sell the government's share of the reserve to the private sector.

Naval Petroleum Reserve Number 2, in Buena Vista Hills, California, covers 30,181 acres and is adjacent to and south of NPR-1. This field has been producing crude oil continually since the early 1920s. The government owns 34.6 percent, while the remainder is privately owned. The government receives royalties from its production land, all of which is leased. Naval Petroleum Reserve Number 3, referred to as Teapot Dome, is a federally owned oil field of 9,481 acres located 35 miles north of Casper, Wyoming. FD Services, Inc. (a subsidiary of Fluor Daniel, Inc.) currently serves as the management and operating contractor.

Naval Oil Shale Reserve Number 1 (NOSR-1) and Number 3 are two adjacent oil shale reserves of 40,760 and 14,130 acres, respectively, located about 8 miles west of Rifle, Colorado, in Garfield County. The government owns all land and minerals at these sites, except for about 600 acres of oil shale at NOSR-1. Naval Oil Shale Reserve Number 2 consists of 90,400 acres located in Carbon and Uintah Counties, Utah. The government owns all the minerals at this reserve, except for those contained in 640 acres of state lands and 320 acres of homestead entries. At present, DOE has no plans to develop this reserve.

THE PROPOSED METHOD OF SALE APPEARS  
CONSISTENT WITH EFFORTS TO ENSURE EQUAL  
OPPORTUNITY TO ALL POTENTIAL BUYERS

The method of sale contained in the draft legislation appears consistent with efforts to provide equal opportunity to all prospective purchasers. The legislation

requires the Secretary of Energy to publish a notice of intent to sell the reserves. It also includes requirements to identify all equipment and facilities included in the sale, and provides for the acceptance of one or more contracts for the sale. We did not identify any language in the draft legislation that excludes prospective buyers. While NPR-1 might prove unaffordable to a small prospective bidder, we did not identify any language in the draft legislation that precludes a group of bidders from forming a consortium for the purpose of bidding on this property.

THE PROPOSED METHOD OF SALE APPEARS  
CONSISTENT WITH EFFORTS TO YIELD A  
FAIR MARKET VALUE TO THE GOVERNMENT

By stipulating acceptance of the highest responsible bid that meets or exceeds the minimum acceptable price set by the Secretary of Energy, in consultation with the Director of the Office of Management and Budget, the proposed method of sale appears consistent with efforts to yield a fair market value to the government. For example, the minimum acceptable price is not to be set below the average of three assessments (after excluding the high and low assessments) made by five independent experts in valuating oil and gas fields in a manner consistent with commercial practices. This makes receiving a fair market value more likely. We note that the minimum acceptable price is to be determined after considering, among other things, the net present value that the Department of the Treasury would receive from the reserves if the reserves were not sold.<sup>3</sup>

The proposed method of sale also requires that equity or ownership shares in NPR-1 belonging to the government and Chevron be finalized before selling that reserve. Equity shares determine how each partner shares in the expenses and profits of that reserve and how much of the hydrocarbons (oil, gas, etc.) belongs to the government and to Chevron. Previously, we reported that if equity shares are not finalized and the government decides to sell its share of that reserve, the price that it would receive could be discounted to reflect uncertainty about the size

---

<sup>3</sup>See Naval Petroleum Reserves: Opportunities Exist to Enhance Its Value to the Taxpayer (GAO/T-RCED-95-136, Mar. 22, 1995) and Naval Petroleum Reserves (GAO/RCED-95-141R, Mar. 17, 1995). As a general principle, fair market value is calculated by using private sector discount rates.

of its share.<sup>4</sup>

Finally, we believe that the proposed method of sale provides the government with appropriate expertise to ensure a fair market value. In addition, it is important to note the oversight of the Office of Management and Budget in many key aspects of the sale, as well as the Department of the Treasury's role in the approval process for the sale. The proposed method of sale authorizes the Secretary of Energy to employ independent experts to value the reserves and finalize equity shares and to use an investment banker to administer the sale.

SALE OF OTHER NAVAL PETROLEUM  
AND OIL SHALE RESERVES

The proposed legislation contains two versions of section 7421b that provide for the disposition of the remaining five naval petroleum and oil shale reserves. The first version requires a study to determine which option--that is, sale, lease, or combination of options--would maximize the value of the remaining reserves to the government. The second version permits only a sale. Both versions postpone final disposition until 1997, and each contains language consistent with efforts to provide equal opportunity to all prospective purchasers and to yield a fair market return to the government, as noted earlier. Furthermore, given the time and effort it will take to sell NPR-1, postponing the disposition of the remaining reserves until 1997 will give the government adequate opportunity to conduct required assessments.

The first version of section 7421b allows greater flexibility in the options available to the government--namely to sell or lease. This could prove beneficial in a situation where less is known about the production potential and value of a given reserve. This version also stipulates that these reserves will be transferred from DOE to the Department of the Interior if a decision is made to lease them.

OTHER ISSUES

The proposed legislation requires an estimate of the cost of any environmental restoration and remediation necessary

---

<sup>4</sup>Naval Petroleum Reserves: Opportunities Exist to Enhance Its Value to the Taxpayer (GAO/T-RCED-95-136, Mar. 22, 1995).

at NPR-1. In conjunction with these cost estimates, it is also important for the government to identify any environmental contamination in order to provide a baseline of environmental conditions at the date of sale. Such a baseline would protect the government's interests, should environmental conditions change after the sale.

The proposed legislation also requires that an independent petroleum engineer complete an assessment of the hydrocarbon reserves and prepare a reserve report containing the quantity of petroleum and natural gas for NPR-1 within 6 months after the effective date of the legislation. Valuation experts may estimate dollar values using data from the reserve report. These valuations must also be completed within 6 months. Having the engineer complete the reserve report first might facilitate valuation because it would contain information on the production potential of the reserve that would be useful to the valuation experts. In addition, having the reserve report beforehand should facilitate finalizing equity shares, which is to be completed within 5 months of the legislation's effective date.

While the proposed legislation provides for the Comptroller General to monitor the sale of the reserves, we believe that the addition of language contained in enclosure II would expedite our access to records directly related to the sale from whatever source and would thereby enhance the timeliness and quality of reports that we make to the Congress. We note for your information that similar language was enacted as section 1213 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

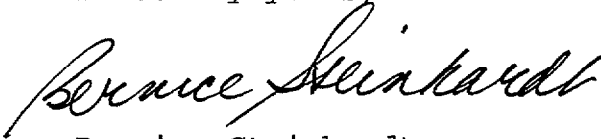
- - - - -

A listing of related reports that we have done is contained in enclosure I. We performed our review in October 1995.

B-270191

We will send copies of this report to the Secretary of Energy and make copies available to others on request. If we can be of further assistance, please feel free to call me at (202) 512-6543.

Sincerely yours,

A handwritten signature in cursive script that reads "Bernice Steinhardt".

Bernice Steinhardt  
Associate Director, Energy  
and Science Issues

Enclosures - 2

RELATED GAO PRODUCTS

Sale of NPR-1 (GAO/RCED-95-255R Aug. 1, 1995).

Naval Petroleum Reserves: Opportunities Exist to Enhance Its Value to the Taxpayer (GAO/T-RCED-95-136, Mar. 22, 1995).

Naval Petroleum Reserves (GAO/RCED-95-141R, Mar. 17, 1995).

Naval Petroleum Reserve: Opportunities Exist to Enhance its Profitability (GAO/RCED-95-65, Jan. 12, 1995).

Naval Petroleum Reserve: Limited Opportunities Exist to Increase Revenues From Oil Sales in California (GAO/RCED-94-126, May 24, 1994).

SUGGESTED LANGUAGE TO EXPEDITE GAO'S ACCESS TO RECORDS

All agencies, corporations, organizations, and other persons that perform any function or activity related to the sale of the (\_\_\_\_\_) shall be subject to audit and review by the Comptroller General of the United States with respect to those functions or activities.

(1) The Comptroller General shall determine the nature, scope, and terms and conditions of documents and/or property that he deems relevant to his oversight responsibility under section (\_\_\_\_\_) of this act.

(2) The Comptroller General and duly authorized representatives of the Comptroller General shall have access to and the right to copy and examine any property, record, or document, including those that may be considered proprietary, confidential, policy, or draft within the control or possession of the entities described in this section that the Comptroller General deems relevant to his responsibilities to oversee the sale of (\_\_\_\_\_) under this act.

(3) The Comptroller General's access and enforcement authority under this section shall be in addition to the authority available to the Comptroller General under title 31 of the United States Code section 716 and any other provision of law.

(302172)



---

---

**Ordering Information**

**The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.**

**Orders by mail:**

**U.S. General Accounting Office  
P.O. Box 6015  
Gaithersburg, MD 20884-6015**

**or visit:**

**Room 1100  
700 4th St. NW (corner of 4th and G Sts. NW)  
U.S. General Accounting Office  
Washington, DC**

**Orders may also be placed by calling (202) 512-6000  
or by using fax number (301) 258-4066, or TDD (301) 413-0006.**

**Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (301) 258-4097 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.**

---

**United States  
General Accounting Office  
Washington, D.C. 20548-0001**

<p><b>Bulk Rate Postage &amp; Fees Paid GAO Permit No. G100</b></p>
---

**Official Business  
Penalty for Private Use \$300**

**Address Correction Requested**

---