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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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JUN 18 1976

The Honorable John E. Moss
The Honorable John D. Dingell
House of Representatives

Your joint letter of October 31, 1975, asked us to examine the effects of a change the Small Business Administration made to its size standard for small business petroleum refiners on October 30, 1975.

In discussions with your offices, we agreed to

--review correspondence and other documents available at the agency concerning the change,

--interview agency personnel who opposed the change,

--examine the former Administrator's appointment book to determine if he had any contacts with companies directly affected by the change, and

--meet with an individual identified by your offices and anyone he would refer us to who had information on the change.

In addition, we attempted to determine whether any petroleum refiners made eligible for small business programs by the change had applied for assistance.

We reviewed records and interviewed officials at the Washington, D.C., headquarters of the Small Business Administration. We also contacted the person identified by your offices, a congressional staff member to whom he referred us, an official of the Department of Defense's Defense Supply Agency, and an official of the Department of the Interior's Geological Survey.

A summary of the information you requested follows. A more detailed discussion can be found in the enclosure to this letter.

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1. The October 1975 change in the size standard for petroleum refiners is one of seven size standard changes the Small Business Administration has made in the last 3 years. The agency considered the change necessary to allow small refiners to expand without losing small business benefits and to compensate for a decrease in the percentage of refiners considered "small" since the adoption of the size standard in 1955.

2. Based on our examination of industry lists and contacts with Federal agencies, we identified eight refiners that may have become eligible for small business benefits as a result of the change. However, as of May 5, 1976, the Small Business Administration was reviewing the eligibility of three of these refiners in order to officially determine their size.

   An official of the U.S. Geological Survey believes that an increase in the number of eligible refiners will cause refiners eligible under the old standard to receive less of the royalty oil, 1/ which the Federal Government reserves for sale to small refiners, than they otherwise would have received. Seven of the eight refiners have expressed interest in purchasing this oil.

3. We discussed the size standard change with three agency officials who had earlier recommended a more limited increase. Instead of repeating their earlier objections to the increase, these officials told us that the new size standard was justified.

4. The former Administrator's appointment book did not show that he was contacted by any refiners directly affected by the size standard change. However, the appointment book is not a complete record of his contacts.

5. Our contact with the individual identified by your offices and the additional source this individual named did not produce documented information about the size standard change not already available in Small Business Administration files.

1/Royalty oil is the product the Government receives as a payment for allowing private concerns to extract oil from Government-owned lands and offshore areas.

We discussed the information obtained with officials of the Small Business Administration, Defense Supply Agency, and U.S. Geological Survey, and their comments have been included where appropriate.

As agreed with your offices, a copy of the report will be sent to Mr. John Cross of the Senate Select Committee on Small Business after it is issued.

R. F. Keller

Acting Comptroller General
of the United States

Enclosure

INFORMATION CONCERNING A CHANGE MADE BY THE SMALL BUSINESS ADMINISTRATION TO ITS SIZE STANDARD FOR PETROLEUM REFINERS

BACKGROUND

Former size standard

In part 121 of chapter I of title 13 of the Code of Federal Regulations, the Small Business Administration (SBA) defines a small petroleum refiner for the purposes of eligibility for (1) small business set-aside contracts, (2) SBA loans, and (3) purchases of Government-owned property reserved for sale to small businesses. The primary Government-owned property of interest to petroleum refiners is the United States Geological Survey (USGS) royalty oil.

Adopted in 1955, this definition (referred to as a size standard) limited eligibility for the above three purposes to refiners with a crude-oil capacity of not more than 30,000 barrels per day (BPD) 1/ and 1,000 or fewer employees.

Proposal to increase size standard

On March 17, 1975, the Administrator 2/ of SBA announced a proposal to amend this definition. The proposal called for an increase in the size standard to 75,000-BPD crude-oil capacity and 1,500 employees or less for the purposes of eligibility for set-aside contracts and SBA loans. It also stated that for eligibility for sales of royalty oil, the size standard should be increased to 60,000-BPD crude-oil capacity and 1,500 employees.

The proposal gave the following reasons to justify increasing the capacity size standard:

"1. The domination of the industry by giant firms;

2. An increase in demand for petroleum products;

1/"Crude-oil capacity" means the maximum daily average crude oil that a refinery in complete operation can process allowing for routine maintenance and repairs.

2/When the proposal was introduced, the Administrator was Thomas S. Kleppe. Mr. Kleppe resigned on October 17, 1975, to become Secretary of the Interior.

3. The greater efficiency of larger refinery operations;

4. The change in the scale of operations made necessary by the new environmental requirements; and

5. The percentage of refining capacity accounted for by small business has substantially diminished since the promulgation of the 30,000 BPD capacity size standard."

SBA also determined that an increase in the employee size standard was justified to permit refiners to diversify into other business fields.

Comments on the proposal by interested parties

All interested parties were invited to file written comments with SBA expressing their opinions on the proposed amendment. As a result of numerous comments and petitions received, SBA held a hearing on August 25, 1975, at which time 15 refiners presented their positions on the proposed change.

The panel for this hearing consisted of three SBA headquarters officials: an Associate General Counsel, the Director of the Office of Financing, and the Director of the Office of Procurement Assistance. On October 15, 1975, the panel recommended to the Administrator of SBA that the size standard of eligibility

--for set-aside contracts and SBA loans be increased to 50,000-BPD crude-oil capacity and 1,500 employees or less and

--for sales of royalty oil not be increased for the capacity standard, but increased to a 1,500 employee standard.

The panel's recommendation for set-aside contracts and SBA loans was based in part on its finding that refiners having between 50,000- and 75,000-BPD capacity did not submit sufficient evidence that they needed SBA assistance to remain competitive. The panel also determined that refiners with capacities not exceeding 50,000 BPD would account for 7.8 percent of the total U.S. refining capacity and would be consistent to that extent with the 30,000-BPD standard adopted in 1955.

The panel justified its recommendation of not increasing the capacity standard for sales of royalty oil as follows.

> "* * * because royalty oil is allocated on the basis of a concern's refining capacity * * * to increase the capacity standard at a time when royalty oil is in limited supply would severely diminish the share now going to each small business to a point where [that share] may lose economic effectiveness."

On October 16, 1975, the SBA Administrator accepted the panel's recommendation to adjust the proposed increase in the size standard for set-aside contracts and SBA loans but did not accept its recommendation of not increasing the capacity standard for sales of royalty oil. The Administrator emphasized that some increase in the capacity standard for royalty oil was needed because of the expanded growth of the petroleum industry since the standard's adoption in 1955 and that failure to do so would unnecessarily prohibit the natural and essential growth of eligible small concerns. According to the Director of SBA's Size Standards Division, the Administrator chose a standard of 45,000-BPD crude-oil capacity as a compromise between the proposed 60,000-BPD standard and the old 30,000-BPD standard.

A revised size standard proposal incorporating the Administrator's decision was sent to him on October 16, 1975, by the Director of the Size Standards Division. Under normal SBA procedures, the proposal would have been reviewed by lower level officials before it was sent to the Administrator. According to the Division Director, however, these officials were bypassed because the Administrator wanted to act on the proposal before leaving the agency and there wasn't enough time for lower level review.

New size standard

The proposal was approved by the Administrator on October 16, 1975, and was published in the Federal Register on October 30, 1975.

The new size standard is:

	Capacity in barrels per day	Employees
For set-aside contracts and SBA loans	a/50,000	1,500
For sales of royalty oil	45,000	1,500

a/In the Federal Register of May 10, 1976, SBA announced that it would hold a hearing on June 9, 1976, on whether the refining capacity standard for set-aside contracts should be raised.

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During 1973-75, SBA changed small business size standards six other times. A change in 1973 affected 1 industry, 2 changes in 1974 affected 17 industries, 2 changes in 1975 affected 19 industries, and a 3d change in 1975 raised all the size standards expressed in dollars to compensate for inflation.

COMMENTS FOR AND AGAINST THE PROPOSED CHANGE

Forty-five parties, including refiners, trade associations, and the Department of Defense, submitted written opinions on the proposed amendment. Thirteen favored the proposal, 17 recommended alternative increases, and 15 opposed any increase.

Among the 45 were 15 petroleum refiners who also presented arguments for and against the proposal at SBA's public hearing. Of these 15, 4 favored the proposal, 7 favored alternative increases, and 4 opposed any increase in the size standard.

Some major arguments for an increase, as expressed in the correspondence and at the hearing, were:

1. The old standard deterred expansion and diversification for smaller refiners that feared losing the right to participate in small business programs.

2. Any refiner that would qualify under the proposed size standard would still be small in comparison to the giant firms which dominate the industry.

3. Many refiners that recently increased their crude-oil capacity over the old standard did so at the request of high Government officials, Members of Congress, and the President, and in so doing, lost their small business status.

4. The size standard should classify the same percentage of the total U.S. refiners as small businesses as it did when the 30,000-BPD standard was adopted in 1955.

5. Small refiners need SBA assistance to become or remain competitive with larger refiners that produce the same type of products, but do so more efficiently as a result of their size.

Some major arguments against an increase, which were also expressed in the correspondence and at the hearing, are as follows.

1. Concerns eligible under the old standard (30,000 BPD) would have problems competing for set-aside contracts with firms in the 50,000- to 75,000-BPD range.

2. The amount of royalty oil is very limited. To increase the number and size of refiners eligible for this program would hurt small refiners eligible under the old standard.

3. The old standard did not deter expansion. In reality, access to crude oil, market limitations, and geographical conditions deter expansion.

4. Small refiners are as efficient as larger refiners in their own markets.

SBA PANEL OPPOSED TO THE CHANGE IN ELIGIBILITY FOR ROYALTY OIL

As stated earlier, considering the limited supply of royalty oil and the arguments presented on it, the SBA panel recommended no change in the capacity standard of 30,000 BPD and an increase to 1,500 in the employee standard for sales of royalty oil. However, the Administrator's final decision was to set the capacity standard for sales of royalty oil at 45,000 BPD.

When we discussed the Administrator's action with the panel members, none of them repeated their earlier objections to an increase in the capacity standard for sales of royalty oil. Instead, all agreed that the Administrator's action was justifiable and said they could foresee no negative effects from the increase.

REVIEW OF THE FORMER SBA ADMINISTRATOR'S APPOINTMENT BOOK

To determine whether the Administrator had had any contact with those refiners directly affected by the change, we looked at his appointment book for 1975. The book is kept by the Administrator's confidential assistant, who said she is the only one who makes entries in the book.

The information in the book was, for the most part, incomplete for investigative purposes. Many entries showed only first names, or names without titles or organization represented, and rarely showed the topic discussed. When the Administrator was out of town, the entries in the book indicate only the town and/or function he attended.

We compared those names which appeared in the book against a listing of the directors and officers of the refiners that may have been directly affected by the change. (See p. 7 for a listing of these companies.) Where the appointment book showed complete names, our comparison did not reveal that the Administrator had had any contact with these refiners.

NEWLY ELIGIBLE REFINERS' PARTICIPATION IN SMALL BUSINESS PROGRAMS

SBA has not compiled a list of refiners which became eligible small businesses as a result of the size standard change. However, from an industry list published by the National Petroleum Refiners Association and from discussions with officials of USGS and the Defense Supply Agency, we have identified eight refiners which may be classified as small businesses as a result of the new standard. However, during our examination, USGS asked SBA to review the eligibility of seven of these refiners in order to officially determine their size. These eight refiners may now be eligible for small business set-aside contracts, SBA loans, and sales of royalty oil. They are: 1/

	Capacity in barrels per day	Annual sales in millions (note a)
Powerine Oil Co., Sante Fe Springs, Calif.	44,120	$295
Good Hope Refiners, Inc., Good Hope, La.	44,000	b/245
Quintana Refining Co., Corpus Christi, Tex.	42,620	b/100
Farmers Union Central Exchange, Inc., Laurel, Mont.	41,650	500
Pride Refining Co., Abilene, Tex.	36,500	N/A
Little America Refining Co., Casper, Wyo.	24,300	80
Midland Cooperatives, Inc., Cushing, Okla.	19,600	171
Indiana Farm Bureau Cooperatives Assoc. Inc., Mount Vernon, Ind.	17,500	631

a/Source: The 1976 Dun & Bradstreet Million Dollar Directory.
b/Combined sales of listed company and affiliates.

These refiners' participation in the three SBA programs noted above is discussed in the following sections.

Small business set-aside contracts

According to a procurement analyst in the Small Business Office of the Defense Supply Agency, the set-aside program requires the Defense Supply Agency to reserve for small refiners a portion of Federal petroleum product requirements equal to their ability to meet these requirements. The analyst said the increase in the number of eligible refiners capable of providing petroleum products would be matched by an increase in petroleum product requirements

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1/As the list indicates, three refiners have a refining capacity of less than 30,000 BPD. These refiners have between 1,000 and 1,500 employees. They were ineligible under the old size standard because of the number of their employees but may be eligible under the increased standard. Employment data for all refiners which had less than a 30,000-BPD capacity was not readily available. Possibly, some of them also had between 1,000 and 1,500 employees and were also made eligible by the new standard. Under these circumstances, our list may not be complete.

set aside for them. The analyst does not expect any refiners eligible for set-asides under the old standard to be hurt by the addition of the newly eligible refiners.

SBA loans

SBA does not anticipate that the increase in the size standard will affect the SBA business loan program since the agency has never made a loan to a petroleum refiner. According to a history of the size standard for petroleum refiners prepared by SBA, the industry is so "capital intensive" that SBA's business loan guarantee limit of $350,000 is far too small to attract small refiners.

However, the Small Business Act provides for economic disaster loans to firms adversely affected by environmental control legislation provided they are eligible as small businesses. Some of the newly eligible refiners may be interested in a disaster loan to finance pollution control equipment to comply with Federal and State regulations. There is no legislative loan limit for these loans. Since SBA has not determined what size refiners need this type of help, it does not know if the program will be affected by the change in the size standard.

Sale of royalty oil

The eight refiners may have also become eligible to purchase royalty oil as a result of the increase in the size standard. Royalty oil is sold by USGS to refiners who qualify as small businesses for this purpose under the SBA definition.

According to the Assistant Division Chief for Operations in the Conservation Division of USGS, royalty oil contracts are usually awarded for 3 years. Contracts currently in effect will terminate in mid-1976, when new contracts will be awarded. Seven of the eight refiners which may have become eligible have applied for contracts.

Six of the seven refiners that submitted applications currently have royalty oil contracts with USGS because they were eligible as small businesses 3 years ago when the contracts were awarded. USGS does not cancel contracts in cases in which a refiner expands beyond the size standard after a contract has been awarded.

According to the Assistant Division Chief for Operations, the increase in the standard may decrease the royalty oil that would otherwise have gone to refiners eligible under the old standard. The amount of royalty oil which

USGS can sell to the small refiners is limited, so the available oil is allocated among the eligible refiners.

A refiner may make a request to purchase royalty oil equal to the difference between its refining capacity and the total amount of crude oil it already has available from other sources. Subject to several limitations, the amount of royalty oil each refiner receives is determined by dividing the total number of applicants into the total amount of royalty oil available.

Since the number of small refiners eligible for royalty oil may have increased as a result of the change, refiners eligible under the old standard may receive less royalty oil than they otherwise would have.

In the Federal Register of March 4, 1976, USGS published proposed allocations, planned to commence in July 1976, of royalty oil produced on the Outer Continental Shelf. Allocations of royalty oil produced onshore were to be determined later. The Outer Continental Shelf allocations are subject to change depending on the amount of onshore royalty oil each refiner is granted in the subsequent allocation and on the number of refiners finally determined to be eligible.

As indicated above, seven of the eight refiners who may have been made eligible by the size standard change applied for royalty oil allocations. The preliminary allocations of the seven refiners for Outer Continental Shelf royalty oil are as follows:

	Barrels per day
Powerine Oil Co.	866
Good Hope Refiners, Inc.	1,890
Quintana Refining Co.	1,890
Pride Refining Co.	1,890
Little America Refining Co.	0
Midland Cooperatives, Inc.	1,890
Indiana Farm Bureau Cooperatives Assoc., Inc.	1,890
Total	10,316

A total of 67 refiners have received proposed allocations totaling 109,773 BPD. If the oil allocated to the refiners shown on the above chart, who may have been made eligible by the size standard change, had been distributed to the other 60 refiners, each could have received an additional allocation of about 172 BPD. In most cases, this would have increased their allocation by about 9 percent.