Questions about MMS small refinery RIK action:

1. Did MMS set the price of oil that the refineries paid?

The bills that MMS prepared were based on the prices reported by the producers of the oil made available for the RIK program. MMS did no additional calculation to adjust the prices when they prepared the bills. Onshore producers are required to report the value that would have been determined for that oil under the regulations had the royalties been paid in value instead of in kind. Offshore producers must report the fair market value of the oil as defined by statute.

2. Did the refineries (refiners) influence MMS in determining the price of oil?

No. See the response to question number one.

3. Does MMS normally audit the small refineries? If yes, for what reason?

MMS normally does not. However, in the past some States with FOGRMA Section 205 delegated audit agreements have audited some of the RIK production sold to small refiners. They identified that some producers were reporting posted prices as value, but were selling the production at postings plus premiums. This surfaced the problem that RIK oil was undervalued because MMS had relied on the producers to report cash royalties based on market value, as required by regulations. MMS used these reported values to bill the small refiners.

Since MMS believed crude oil was being valued properly by the producers, it had, in its audits of major companies, only verified that the volumes reported as RIK were, in fact, delivered to the small producers.

4. Is MMS only auditing the small refineries because it determined through its oil valuation rule that MMS sold oil below market value?

This problem was surfaced as discussed above. In 1996, when we announced a plan to conduct audits of crude oil value specifically in California and also nationwide, the small refiners were included since, during 1995 and 1996, RIK royalties represented in the range of 35% of all oil royalties.

5. If MMS established an independent price for the oil, why does MMS believe it can now go back and bill small refiners for additional amounts?

The regulations governing Royalty In Kind (30 CFR 208) require that MMS receive fair market value for the oil that it sells to small refiners. They further provide that if MMS underbills a refiner/purchaser because the producer/payor who provided the oil undervalued it, MMS may bill the refiner for the additional value.

6. It appears that the government got from the small refiners what it thought the fair market value of the oil was at the time. Why should the small refiners be liable for what appears to be a

government mistake?

We relied on the information reported by the producers until, through audits, we determined that oil was not sold at fair market value. As noted in our response to question five, we have the authority to pursue small refiners for additional amounts.

7. Did the refiners profit more because MMS undervalued the oil, or is it reasonable to assume that the refiners used the price they paid MMS to determine the selling price of their products, if the MMS price was higher, the refiners would have had to increase their selling price to make a profit?

Since crude oil is only one of several refinery costs, it is not reasonable to assume that they would solely base the selling price of their refined products on the purchasing price of crude oil Product prices would be based on what the market would bear.

8. It does not appear that small refiners are at fault in MMS undervaluing the price of oil it sold. Do you agree?

Because they operate in the market and conduct transactions with entities other than the Federal government, it seems logical that they would be aware of the full range of oil prices and therefore know if MMS is underbilling. On the other hand, the terms of their contract call for them to pay what they are billed by MMS and by timely paying the amount billed, they are fulfilling the terms of their contract. However, as noted above, the regulations allow for additional value to be pursued.

9. If they are not at fault, then this was a government mistake. Why can=t MMS administratively stop the audits and billings?

Because the regulations require that MMS receive the proper price for the oil, we cannot abdicate that responsibility and administratively forgive the additional amounts.

10. Explain why you have this program and what qualifies a refiner to enter the program.

Under the Mineral Leasing Act of 1920 and the Outer Continental Shelf Lands Act of 1953, the Federal government, as lessor, may take part or all of its oil and gas royalties in kind. The Secretary of the Interior, exercising discretionary authority, has historically determined that certain oil refiners do not have access to a secure supply of crude. The Federal government may direct Federal lessees to pay their royalty shares in crude oil, rather than in value. The government then sells the RIK to eligible refiners.

In order to be eligible to receive oil under this program, a refiner:

> A) who wishes to purchase onshore oil must qualify as a small and independent refiner pursuant to the Emergency Petroleum Allocation Act.

B) who wishes to purchase OCS oil must qualify as a small business enterprise under the rule of the Small Business Administration.

11. What is the volume of oil that MMS provides small refiners, and what percentage is this of the total amount of royalty oil?

Attached is a chart which compares total production on in-value leases to the total production on RIK leases

	In Value Lease Production	RIK Lease Production	Percentage
1993	489,389,763	31,799,930	6.5
1994	488,715,126	27,772,995	5.7
1995	530,452,147	164,788,653	31.1
1996	559,537,949	210,773,050	37.7

Note: The significant increase in 1995 and 1996 resulted from increased offshore production sold under the RIK program.

RIK Questions--OMB

12. On the historical chart MMS provided on volumes, the table starts with the year 1993, is this the first year of the program? If not, do you have volumes since the program started and would you provide the numbers to us?

Answer: The RIK program began many years before the MMS was formed and was managed by the U.S. Geological Survey. Volumes of RIK production as a percentage of total production from 1976 forward is being provided in a separate chart.

13. Please provide us a breakout of the estimated state underpayment dollars involved? If this is available by state please provide a list by state.

Answer: The total underbilling potential we have estimated for onshore RIK production is in the range of $34-$38 million. We have not further segregated this amount by the States involved since most of the contracts provided for purchasing RIK production from leases in more than one state.

14. Please provide a list of refiners who participate in the program--past and present, and their location(state).

Answer: As indicated in the answers to question 12, MMS does not have records sufficient to answer this question prior to the mid-1980's as the program was managed by another agency and the records are not available. The more current participants and the location of their refineries are listed below.

Onshore Contracts	Refinery Location
Big West Oil Company	Utah
Gary-Williams Energy Corp.	Oklahoma
Sinclair Oil Corporation	Wyoming
Wyoming Refining	Wyoming
Offshore Contracts	
Gold Line Refining	Louisiana
Gary-Williams Energy Corp.	Oklahoma
Gary-Barrett	Oklahoma
Age Refining Inc.	Texas
Calcasieu Refining Company	Louisiana
Canal Refining	Louisiana
LL&E Petroleum Marketing, Inc.	Alabama
Giant Industries Arizona, Inc.	New Mexico
Placid Refining	Louisiana
U. S. Oil and Refining Company	Washington

15. Given that MMS has the legislative authority to run the small refiner RIK, why did MMS start the program?

Answer: MMS inherited the RIK program from its predecessor agency, the U. S. Geological Survey.

16 We understand that MMS has tried to eliminate the program over the years, but Congress or others forced MMS to continue it. Who wanted MMS to continue the program and what means did they use to force MMS to continue?

Answer: During the mid and late 1980's, MMS did not believe the RIK program was necessary because the refiners did not appear to have any problems obtaining adequate supplies of crude for refining. Accordingly, it proposed several times as a budget reduction step to eliminate the RIK program. Each time, Congress chose to continue the program and appropriated funds for its continuance.

17. Given what has happened, should MMS continue the program in FY2000?

Answer: The major problems experienced in recent years-- financially unstable refiners and MMS=s underbilling-- have been corrected. Several refiners have dropped out of the program and the value of future RIK production has been resolved by negotiating new pricing standards to be effective beginning in August 1998. The current contracts continue through 1999. Prior to the expiration of these contracts, MMS will conduct a formal determination of need to assess if the program should be continued.

RIK Production as a Percentage of Total Federal In Value Production, CY 1976-97

	In Value Lease Production	RIK Lease Production	Percentage
1976	485,044,768	253,539,415	52.27%
1977	468,415,734	232,293,282	49.59%
1978	452,129,072	248,699,388	55.01%
1979	438,232,240	235,759,773	53.80%
1980	427,088,262	234,651,683	54.94%
1981	445,342,103	201,983,121	45.35%
1982	470,624,220	103,907,466	22.08%
1983	499,787,998	94,966,216	19.00%
1984	522,578,436	180,505,257	34.54%
1985	559,292,983	75,628,945	13.52%
1986	546,513,491	19,815,688	3.63%
1987	516,119,163	46,993,660	9.11%
1988	459,657,028	60,152,112	13.09%
1989	437,872,999	51,520,151	11.77%
1990	470,361,526	51,237,491	10.89%
1991	448,822,223	44,863,656	10.00%
1992	487,211,424	36,126,779	7.42%
1993	489,389,763	31,799,930	6.50%
1994	488,715,126	27,772,995	5.68%
1995	530,452,147	164,788,653	31.07%
1996	559,537,949	210,773,050	37.67%
1997	594,835,850	150,658,804	25.33%
Totals	**10,798,224,511**	**2,758,497,715**	**25.55%**