CALCASIEU REFINING COMPANY

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Minerals Management Service
Royalty Management Program
Rules and Procedures Staff
P. O. Box 25165, MS 3101
Denver, CO 80225-0165

Re: Establishing Oil Value for Royalty Due on Federal Leases

Comments of Calcasieu Refining Company (CRC) relative to the Notice of Proposed Rulemaking published in Federal Register Volume 62, No. 16 are as follows:

CRC entered into a contract with MMS expecting to benefit from the U.S. Government program which was established to assist Small Business Refiners in their efforts to obtain supplies of crude oil at equitable prices. That program provides for the Secretary of The Department of the Interior to determine "...if eligible refiners do not have access to adequate supplies of crude oil at competitive prices." When he so determines it permits the sale by the MMS of RIK crudes to eligible refiners. A reasonable interpretation of the words "competitive prices" is the prices at which integrated oil companies are able to buy crudes. Most of the crude oil produced in the U.S., both onshore and offshore, is initially purchased at the leases on a posted price basis. However, the limited operations of most small refiners will not permit adequate staffing to handle the many legal and administrative responsibilities of lease crude purchasing. If small refiner competitors are able to acquire a significant portion of their crudes on a posted price basis, small refiners need to be able to acquire a significant portion of their crudes on a posted price basis.

For the last few years there has been a wide dispersion among companies on posted prices, and some companies' posted prices may be too low to be indicative of realistic market values. Therefore, the MMS has put forth a proposal wherein royalty oils would be priced at values equivalent to average of NYMEX spot prices for crude after adjustments for quality and location. Almost all, if not all, representatives of various segments of the petroleum industry (trade associations, large integrated companies, independents, etc.) have expressed serious objections to the new system being proposed by MMS. It would result in extensive reporting and paperwork and would cause considerable additional administrative work. Furthermore, use of average spot NYMEX prices to determine royalty oil prices is incompatible with 30CFR206.52(c)(1). That regulation requires that duration of crude sales contracts be considered when determining crude pricing values. Generally, the average prices for crudes sold under term contracts are lower than average of spot prices. Purchasers of crude would not sign longer term purchase contracts if they did not expect to have to pay more for crudes on a spot basis. On a spot purchase basis they could swing purchases up or down as needed.

We think the MMS should look at U.S. Government's experience in selling crudes from the strategic petroleum reserve. Sales were not made at adjusted NYMEX prices. A differential normally exists between spot NYMEX prices and sales of volumes to be lifted on a term basis. Longer term contracts generally have lower prices relative to the spot market than short term contracts.

It is our view that the MMS has not adequately investigated the possibility of finding a way to get reasonable prices set using a benchmark basis such as posted price. One example of how the problem might be corrected is to use the average prices posted by petroleum companies but disallow the use in those averages of any posted prices which are more than X¢/barrel (say 30¢) below the average of the companies posting the highest prices.

Over the past several years CRC obtained a large share of its feedstocks from the MMS under the RIK program. It has also purchased almost 40% of its total crude supplies under term contracts with producers, primarily offshore lease holders, at prices significantly below the adjusted spot NYMEX price being considered. The prices at which the producers have been willing to sell crude rather than adjusted NYMEX prices should be construed as the fair market prices for crudes.

Turning to the specific "Preliminary Options for Consideration" MMS memorandum concerning the RIK program, comments are as follows:

1 - The current basis for crude sales to small refiners under the RIK program results in each company incurring many extra banking costs and administrative costs in acquiring those crudes versus purchasing crudes on the open market. Some of these costs are:

a - Posting of a long term bank letter-of-credit to the U.S. Government to assure payment of all funds due, including any adjustments thereto many months after any crude is purchased.

b - Negotiating and effecting crude exchanges with other companies to get the RIK barrels converted to actual barrels of crudes delivered to the refinery for processing. CRC has had to negotiate an average of between 2 and 2-1/2 barrels of crude exchanges for each barrel of RIK crude acquired. This many exchanges are needed to get the dribs and drabs of small parcel purchases from individual leases converted to crude barrels with reasonable batch size and location for transportation to CRC. Considerable negotiations and administrative work are required for each exchange; furthermore it is necessary to provide a bank letter-of-credit or other security guarantee for each barrel of crude obtained in such exchange with significant financial costs being involved. In addition to the time and effort to negotiate the exchanges and to carry out the related financial activities a further administrative burden is imposed by the requirement for sending a copy of the contract for each exchange to the MMS.

c - Maintaining detailed and voluminous accounting records of acquisitions from individual leases in order to compile statistical crude payment and crude exchange information.

d - Paying the MMS administrative costs associated with the RIK program.

2 - If any of the options set forth in that document are followed and if the acquisition bases now set forth in 30CFR remain in effect It does not appear that there will be an incentive for small business refiners to acquire RIK crudes. Each refiner could acquire crudes at significantly lower total delivered costs by entering into term purchase agreements with other entities for crude tributary to its operations.

3 - If changes were made in regulations to the extent needed to make RIK crude purchases attractive to small business refiners the features of Option 2 appear to be the best of the three options quoted. Aggregation of volumes at one or more sales points would reduce the number of exchanges needed for a small refinery to obtain its feedstock and reduce the financing costs associated with the exchanges. It should also reduce the company's accounting and other administrative costs.

Sincerely,

FMDoughty

Findly M. Doughty
President