

*MMS Royalty in Kind
Energy Policy Act Section 342
FY 2007 Report to Congress*

*Presentation to:
Royalty Policy Committee*

September 18, 2008



Topics Covered

- Program Status and Highlights

- Energy Policy Act Section 342 Reporting Requirements
 - Revenues, Costs, and Savings Incurred from RIK
 - Administrative Cost Performance
 - Efficiency Gains
 - Revenue Performance
 - Methodologies for Conversion from RIV to RIK and Performance Standards
 - Evaluation Supporting FY 2007 Conversion of Leases from RIV to RIK
 - Other Public Benefits

- FY 2008 Activities



Overall Status of RIK Program – FY 2007

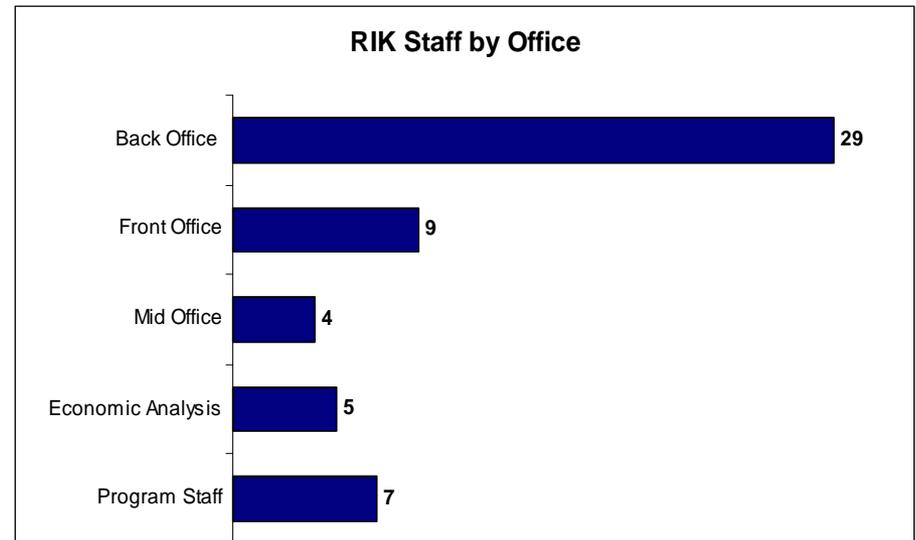
- Program Size/Scope
 - Over 90.5 million BOE
 - Over \$4 billion in revenue
- Natural Gas sold in 25 portfolios
 - Over 90 transportation, processing and other service contracts
 - 20 different counterparties
 - Over 150 individual competitive bids during each sale in FY 2007
- Crude Oil sold in 3 portfolios
 - Over 12 transportation and other service contracts
 - 11 different counterparties
 - 6 sales and 19 different competitive bidders during FY 2007

RIK Program Status, cont.

- Supported by a staff of 54 with expertise in:

- Asset Management
- Accounting
- Credit Analysis
- Economic Analysis

- Headquartered in Lakewood with a Houston office



- Many process improvements implemented in FY 2007
 - Sales procedures improved and documented
 - Strengthened internal controls
 - Coordination with MMS Procurement Office



RIK Revenue Performance Standards

- RIK calculates a Fair Market Value (FMV) Benchmark
 - Benchmark calculated through analysis of market alternatives adjusted for transport, quality and processing netted back to the RIK point of sale
- Compares FMV to price received for RIK production
- Resulting gains/losses are reviewed by Front Office Managers, RIK Deputy Program Manager, RIK Program Director, and approved by Chief Risk Officer



Natural Gas RIK Highlights

- Gulf of Mexico, Wyoming and gas sales on behalf of BLM from the National Helium Reserve
- \$1.8 billion in sales from 25 pipelines
- Nearly 280 million MMBtu
 - Up over 90 million MMBtu from FY 2006

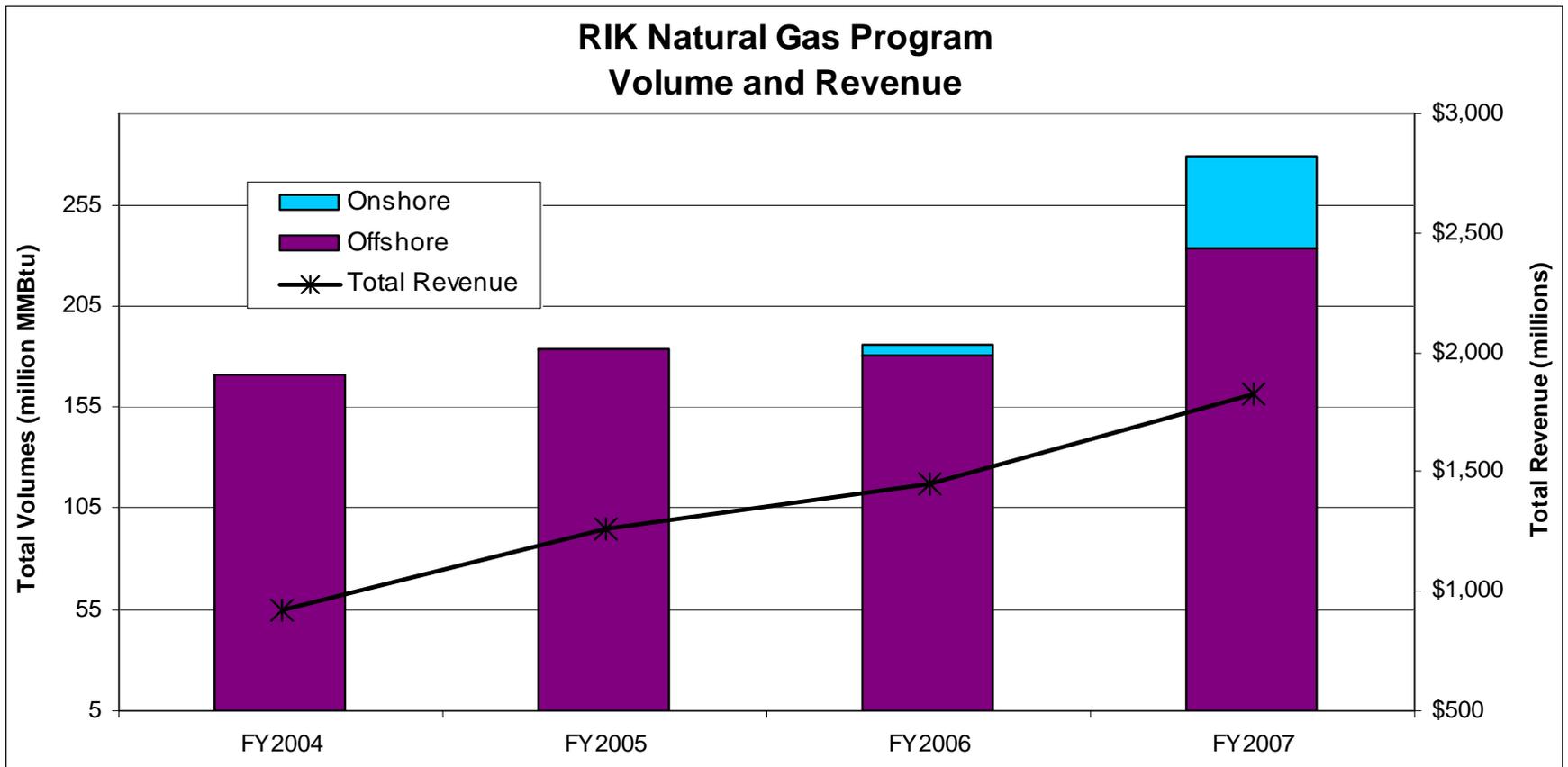
Natural Gas Revenue Performance

RIK Natural Gas - RIK Values vs. FMV Benchmark Values					
	RIK Volumes Sold (MMBtu)	RIK Revenues	Revenue Gain (Loss) vs. FMV Benchmark Price	Revenue Gain (Loss) Per MMBtu	Percent Gain / Loss
Gulf of Mexico	232,887,752	\$1,632,382,454	\$24,302,030	\$0.104	1.49%
Wyoming	45,662,862	\$196,980,687	\$13,618,085	\$0.298	6.91%
Total	278,550,614	\$1,829,363,142	\$37,920,116	\$0.136	2.07%

□ Revenue uplift due to:

- Much higher RIK volumes due to 5 new pipelines in the Gulf and 2 new packages in Wyoming
- High uplift in Wyoming due to very favorable processing contract
- Gains from other advantageous processing and transportation positions maintained throughout FY 2007

RIK Natural Gas Program





Crude Oil RIK Highlights

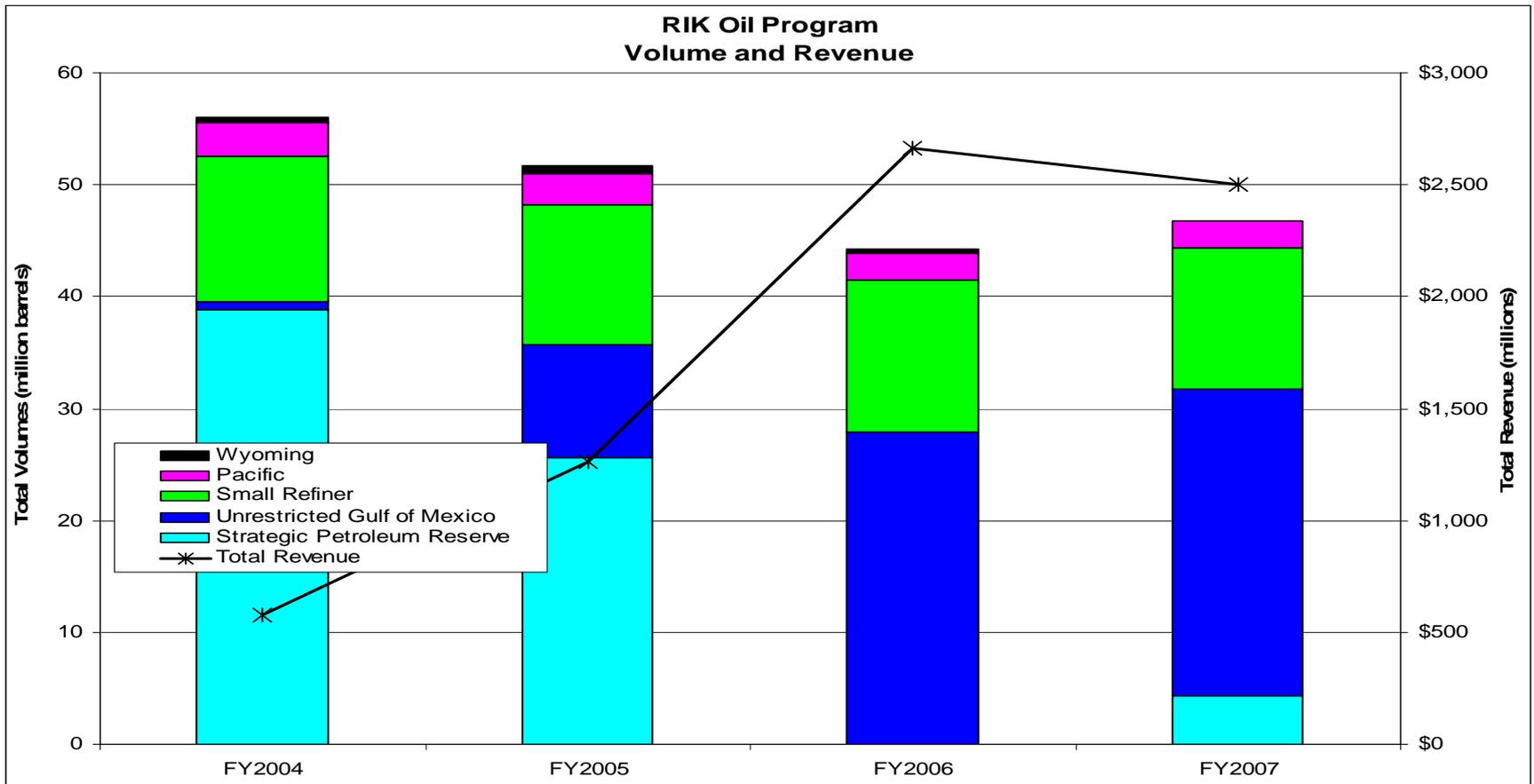
- Three portfolios:
 - Small Refiner,
 - Unrestricted, and
 - Strategic Petroleum Reserve (SPR)
- 42 million bbls sold
 - Not including 4 million bbls used for SPR in FY 2007
- \$2.5 billion in sales
 - Not including value of SPR oil of \$306 million in FY 2007

Crude Oil Revenue Performance

RIK Crude Oil - RIK Values vs. FMV Benchmark Values					
FY 2007 (Oct-06 Through Sep-07) Totals					
	RIK Volumes Sold (bbls)	RIK Revenues	Revenue Gain (Loss) vs. FMV Benchmark Price	Revenue Gain (Loss) Per bbl	Percent Gain/ Loss
Small Refiner	12,627,650	\$781,158,791	\$3,043,275	\$0.241	0.39%
Unrestricted	29,856,312	\$1,717,371,868	\$15,571,338	\$0.522	0.91%
Total	42,483,962	\$2,498,530,659	\$18,614,613	\$0.438	0.75%

- Revenue uplift due to:
 - Crude oil price increases during FY 2007 - RIK crude oil sales contracts use “calendar month” pricing instead of earlier “trade month” pricing used in some industry sales contracts
 - Volumes recovered after Hurricanes Katrina and Rita
 - Purchasers passing downstream economic benefits to RIK

RIK Crude Oil Program



FY 2007 - Administrative Cost Savings

- FY 2007 was the fourth year for a full comparative costing of RIK and RIV
- Savings due to less audit/review costs in RIK and no appeals related to RIK properties

Administrative Cost	FY 2004	FY 2005	FY 2006	FY 2007
Royalty In Kind Cost Per BOE	\$0.056	\$0.059	\$0.076	\$0.071
Royalty In Value Cost Per BOE	\$0.073	\$0.102	\$0.108	\$0.114
Cost Per BOE Difference	\$0.017	\$0.043	\$0.033	\$0.043
RIK Revenue Gain/Loss	\$1,447,051	\$3,725,372	\$2,368,227	\$3,553,392

FY 2007 – Time Value of Money

- RIK payments are received on average five to ten days earlier than RIV payments
- Apply a fixed 3% annual interest rate to account for receiving the funds earlier
 - Fed Funds rate averaged 5.2% during FY 2007 – 3% yields conservative estimate
 - Will use a market interest rate in FY 2008

RIK Time Value of Money Benefit				
	FY 2004	FY 2005	FY 2006	FY 2007
TVM Earned - Oil	\$461,030	\$1,023,548	\$1,996,859	\$2,306,589
TVM Earned - Gas	\$431,845	\$505,002	\$636,111	\$782,483
Total TVM Earned - RIK	\$892,875	\$1,528,550	\$2,633,470	\$3,089,072
Total TVM per BOE	\$0.010	\$0.026	\$0.035	\$0.034

FY 2007 Overall Performance Results

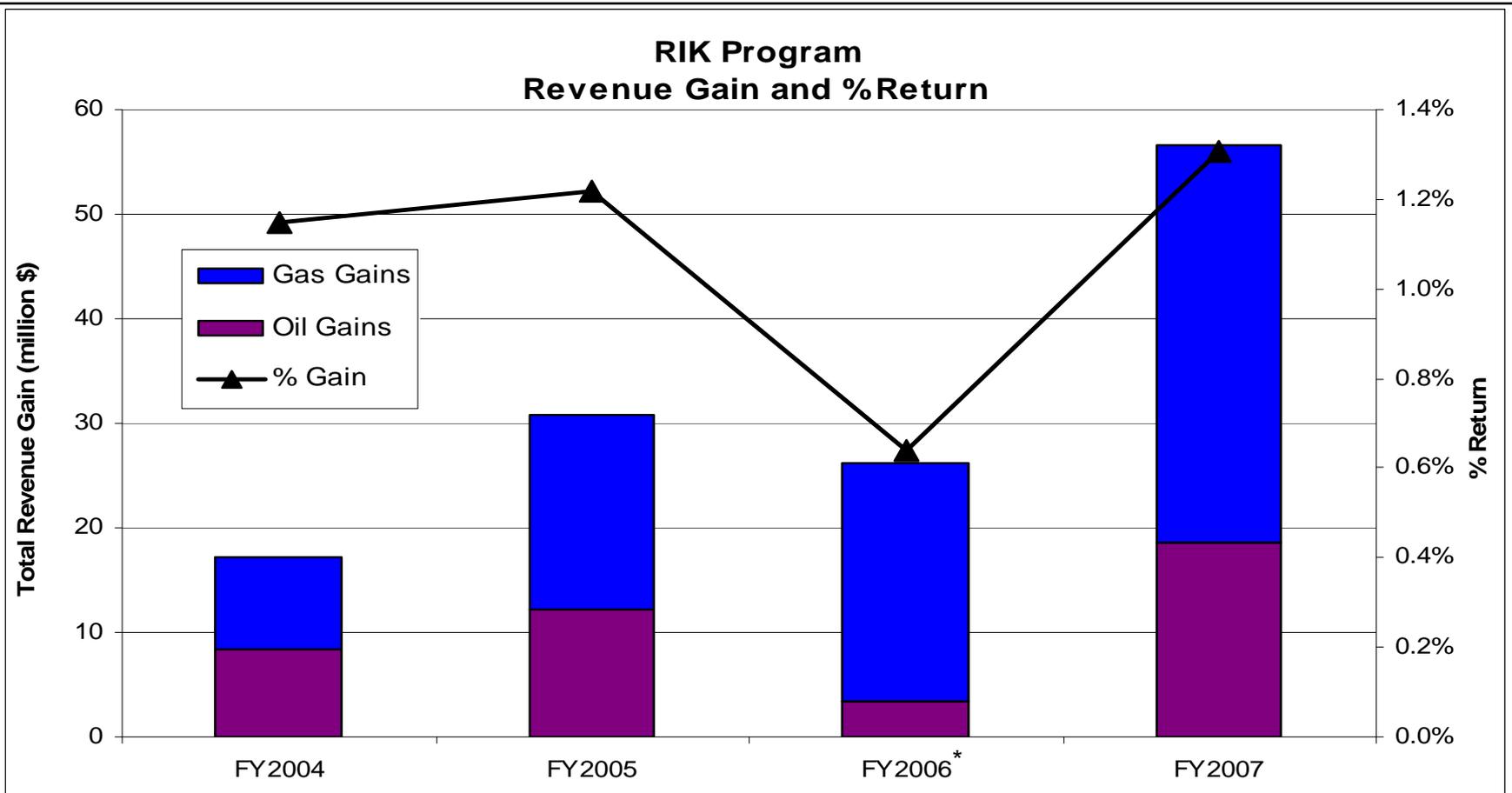
Total Benefits of RIK Program - FY 2007			
	Crude Oil	Natural Gas	Total
Administrative Savings	\$1,826,810	\$1,726,582	\$3,553,392
Time Value of Money Benefit	\$2,306,589	\$782,483	\$3,089,072
Revenue Performance	\$18,614,613	\$37,920,116	\$56,534,729
Total Benefits	\$22,748,012	\$40,429,181	\$63,177,192

FY 2004-2007 Overall Performance

Total Benefits of RIK Program	FY 2004	FY 2005	FY 2006	FY 2007
Administrative Savings	\$1,447,051	\$3,725,372	\$2,368,227	\$3,553,392
Time Value of Money Benefit	\$892,875	\$1,528,550	\$2,633,470	\$3,089,072
Revenue Performance	\$17,242,415	\$30,790,482	\$26,254,845	\$56,534,729
Total Benefits	\$19,582,341	\$36,044,404	\$31,256,542*	\$63,177,192

** Production and Market Impacted due to Hurricanes Katrina & Rita*

RIK Historical Revenue Performance Gains



* Production and Market Impacted due to Hurricanes Katrina & Rita



FY 2007 Conversion of Leases from RIV to RIK

- Natural gas lease production converted from five offshore pipelines
 - Dauphin Island Gathering System (DIGS)
 - Destin Pipeline
 - Discovery Gas Transmission
 - Sea Robin Gas Pipeline
 - Tennessee (Grand Chenier) Gas Pipeline System
- Natural gas production from two onshore fields in Wyoming converted
 - Jonah
 - Pinedale Anticline
- Crude oil production from one offshore crude oil property converted for use in SPR fill



Methodology for RIK/RIV Analysis

- Gather and research public industry information, pipeline system maps, energy publications, transportation routes, processing options, etc.
- Research is focused on each property's economic case, royalty in value payments, and the potential options for economic improvement
- Request transportation and processing proposals from prospective service providers
- Compare results to royalty in value reported by producers
- If results are favorable, complete conversion analysis document, and convert to in kind with approval by Management



Other Public Benefits

- Market knowledge shared with other MMS operations
 - Formal procedures for information sharing now in place
- RIK Program able to provide data necessary in times of natural disasters, such as the 2005 hurricanes, to support continuity of operations for DOI and other agencies



Recent Reviews and Action Plans

- Royalty Policy Committee-Subcommittee on Royalty Management
 - December 2007
 - 12 of 31 recommendations completed

- Office of the Inspector General
 - May 2008 – RIK Oil Sales Process evaluation
 - 6 areas for improvement – procedures, legal support, contracting process, staffing, alternative sale methodologies, and long-term contract
 - Many align with RPC Report recommendations

- Government Accountability Office
 - August – Statement of Facts / Draft Report
 - MMS is addressing concerns regarding production verification and the interest rate used in the Time Value of Money Benefit calculation



Major RIK Initiatives in FY 2008

- Anticipate no new sales packages being added
 - Significant production growth expected in Wyoming natural gas
- Utilizing long-haul transportation on Rockies Express
- Evaluating and acting on recommendations from internal and external reviews
- Developing new business plan for RIK Program to cover FY 2010-2012
- SPR suspended June 30, 2008