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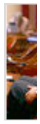

SEPTEMBER 11, 2008

Federal Oil Officials Accused In Sex and Drugs Scandal

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By STEPHEN POWER

WASHINGTON -- Employees of the federal agency that last year collected more than $11 billion in royalties from oil and gas companies broke government rules and created a "culture of ethical failure" by allegedly accepting gifts from and having sex with industry representatives, the Interior Department's top watchdog said Wednesday.

A report by the Interior Department's inspector general, Earl Devaney, described a party atmosphere at the Denver office of the Minerals Management Service, a bureau of the department. Some employees of the office, which houses the department's royalty-in-kind program, "frequently consumed alcohol at industry functions, had used cocaine and marijuana, and had sexual relations with oil and gas company representatives," the report said, adding that "sexual relationships with prohibited sources cannot, by definition, be arms-length."

The report also says that between 2002 and 2006, 19 employees in the agency's royalty-in-kind program, roughly a third of the program's total staff, had "socialized with and had received a wide array of gifts from oil and gas companies with whom the employees were conducting official business."

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Mr. Devaney's blistering assessment spotlights the agency as Congress and the presidential candidates weigh proposals to expand offshore drilling. "We discovered a culture of substance abuse and promiscuity," his report said.

The Minerals Management Service oversees the nation's natural-gas, oil and other mineral resources on the outer continental shelf, and its duties include drawing up leases for drilling in offshore waters. In some years, it is the second-largest source of revenue for the U.S. Treasury, behind only the Internal Revenue Service. Through the royalty-in-kind, or RIK, program, the government receives oil instead of cash payments from energy companies in exchange for drilling rights.

"The activities at the [royalty-in-kind] office are so outlandish that this whole IG report reads like a script from a television miniseries -- and one that cannot air during family viewing time," House Natural Resources Committee Chairman Nick Rahall (D., W.Va.) said in a statement. "It is no wonder that the office was doing such a lousy job of overseeing the RIK program; clearly the employees had 'other' priorities in that office."

The report said that most industry representatives who were interviewed by the inspector general's office admitted buying meals, drinks and entertainment for government employees, but denied they were made in exchange for preferential treatment, according to the report.

Gift Givers

The report named four companies -- Chevron Corp., a U.S. unit of Royal Dutch Shell PLC, Gary-Williams Energy Corp. and Hess Corp. -- as gift givers. In a written statement Wednesday, the Shell unit said it cooperated fully with the investigation, but that it would be

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premature to comment on the report "until we have an opportunity to review the content." A spokesman for Hess said the company had cooperated with the inspector general's inquiry, and that the company's own investigation "indicated no wrongdoing" by employees. Officials at Gary-Williams Energy couldn't be reached Wednesday for comment.

Below the Surface

As offshore drillings expands, so does the importance of the Minerals Management Service.

Source: Interior Department

Democrats seized on the inspector general's report as evidence of what they say is the Bush administration's cozy relationship with the oil industry. Congressional Republicans accused Democrats of not following up on earlier Republican-led investigations of possible wrongdoing within the bureau.

In a teleconference with reporters Wednesday, MMS director Randall Luthi said he didn't see any evidence that American taxpayers had been hurt financially by the alleged misconduct. But he said he took the report's findings "very seriously" and would review the allegations and consider taking appropriate action in the coming months.

Mr. Luthi, who took office in July 2007, said the royalty-in-kind program generated tens of millions of dollars in additional government revenue during the most recent fiscal year, compared with what would have been received if the agency had taken its royalties in cash.

Wednesday's report is the latest black eye for the Minerals Management Service. In July, a former aide to the agency's associate director of minerals revenue management pleaded guilty in U.S. District Court to violating conflict-of-interest laws. The employee, Jimmy W. Mayberry, 65 years old, acknowledged helping create a consulting position that he later took after retiring from government.

In a memo to Interior Secretary Dirk Kempthorne made public Wednesday, Mr. Devaney said his office had referred cases against two other former high-ranking MMS officials to the Justice Department, but the department had declined to prosecute.

Mr. Devaney said some MMS employees who acted inappropriately should be removed, but others had escaped punishment "by departing from federal service, with the usual celebratory send-offs that allegedly highlighted the impeccable service these individuals had given to the Federal Government. Our reports belie this notion."

The report also criticizes what it says was "the ultimate refusal of one major oil company, Chevron, to cooperate with our investigation." A spokesman for Chevron said Wednesday that the company couldn't comment on the report because it hadn't yet seen it. "We have cooperated with the government investigation and produced all of the documents that the government requested months ago," the spokesman said.

Avoiding Payments

In recent years, the Interior Department has come under criticism from Mr. Devaney's office for mistakes at MMS that allowed oil companies to avoid paying royalties for offshore-drilling rights -- errors that government auditors have estimated will cost taxpayers as much as $10.5 billion over about 25 years.

In May, a report by Mr. Devaney's office said an investigation of the program by his agents found that "the integrity of the RIK oil sales process is undermined by poor business practices," with companies often allowed to modify their bids after the deadline for submitting them. Of 718 bid packages awarded to companies between 2001 and 2006, Mr. Devaney's report said, 121 were modified, with only three modifications favoring the government. The value of the modified bid packages not in favor of the government totaled $4.4 million, according to Mr. Devaney's May report.

Under the royalty-in-kind program, the government receives oil or natural gas instead of cash for payments of royalties from companies that lease federal property for oil and gas development. The government then sells the product into the marketplace and returns the proceeds to the Treasury. Interior Department officials say the program results in higher revenue collections and lower administrative costs.

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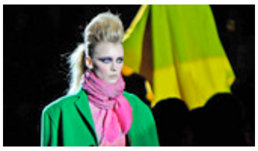
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