UNITED STATES GENERAL ACCOUNTING OFFICE
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STATEMENT OF
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COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
ON
THE DEPARTMENT OF ENERGY'S
GASOLINE ALLOCATION PROGRAM

Mr. Chairman and Members of the Subcommittee:

We welcome this opportunity to discuss our April 1980 report to the Congress entitled, "Gasoline Allocation: A Chaotic Program In Need Of Overhaul". 1/

The report was prompted by requests from 13 U.S. Senators and Representatives who, in the aftermath of the Iranian oil cutoff, were concerned about the Department of Energy's (DOE's) management of the summer 1979 gasoline and diesel shortages. We addressed the adequacy of DOE's allocation information and the ability of DOE and State energy officials to act in critical supply shortage situations to allocate available supplies fairly and in accordance with priority needs.

My statement will provide background on the gasoline allocation program and highlight our report findings and conclusions. I would like to provide a copy of our report for the record.

1/EMD-80-34, Apr. 23, 1980.

The public record is replete with evidence of DOE and its predecessor agencies responding poorly to energy emergencies. The primary causes of these failures can be summed up as inadequate planning, lack of preparedness, and no central responsibility for leadership and direction. The 1979 gasoline shortage is yet another example of our lack of preparedness to minimize the impacts of energy emergencies, and a reminder of our continued dependence on foreign oil supplies and the ever-present threat of supply disruptions.

When the supply shortage began in early 1979,

--the Nation's emergency response planning was incomplete and outdated, and

--Federal and State Governments were ill-prepared to deal with their supply management role.

DOE's program operations were plagued by inadequate management and staffing, relentless demands for services, poor or totally lacking information systems, and unclear guidance and direction. Even under the best of conditions, the workload would have been formidable; in this instance, it was overwhelming.

In the five DOE regional offices we visited, there were large processing backlogs with several adverse effects. Those seeking relief through DOE suffered by not receiving timely service. They sometimes turned to the States for help, but, like DOE, they had not prepared to deal with the sudden workload, and were handicapped by the absence of clear Federal guidance.

Much of the workload that consumed DOE's resources could have been averted if program requirements had been better defined and understood, and if an improved "base period" had been used to determine the quantity of gasoline that purchasers were entitled to. These measures, coupled with improved monitoring activities and a strong audit and enforcement program, would better insure that the program operates as intended.

DOE's audit activities were belated and of mixed success. However, these audits and the work we performed indicated a high incidence of possible violations of the allocation regulations.

We concluded that the program failed to meet its intended objectives and is so seriously flawed that a major overhaul will be needed before better results could be expected the next time.

The legislative authority for the allocation program expires in October 1981. The Congress will doubtless consider whether or not to extend that authority or to provide for another program.

Under the Energy Emergency Conservation Act of 1979, rationing can be used only if the shortage is 20 percent or more, unless the President considers a lesser shortage to be a danger to national security. The gasoline allocation program is intended to manage the distribution of petroleum supplies when shortfalls are under 20 percent.

The United States will continue to risk shortages as long as it depends, in substantial part, on imported energy. Furthermore,

in a product-short situation, industry decisions and practices, based as they are on profit motivations, may not satisfy public interests or needs and will warrant Government intervention.

Consequently, despite its shortcomings, our best judgment at this time is that efforts should be made to make the allocation program an effective tool.

HOW THE PROGRAM IS SUPPOSED TO WORK

Before discussing the details of our work, some background information may be helpful.

Following the 1973 oil embargo, the Congress provided legislative authority to deal with energy shortages and to assure both sufficient supplies to priority users and equitable distribution of supplies nationwide. DOE is now responsible for satisfying these legislative objectives. Individual States also play a key role in implementing the petroleum allocation program.

The regulations affect the gasoline distribution system from the refiner to wholesalers to retail stations and bulk end-users. Under present regulations, gasoline allocations are determined by reference to a historical base period. Suppliers must sell to the same purchasers who bought during the base period, although the purchasers are not obligated to buy the volumes offered them.

The amounts purchased during the base period (base period volume) are used to determine the quantity to which purchasers are entitled. Certain national defense, agricultural, and other users are given priority in receiving gasoline.

A "set-aside" program permits States to direct the distribution of a portion of the gasoline to meet hardship and emergency requirements within the State. Each prime supplier (a refiner or wholesaler who first transports gasoline into a State) must set aside 5 percent of the supplies for this purpose.

The first attachment to my statement is a hypothetical example of how the allocation process affects three refiners, two wholesalers, and three retailers. The allocation process begins with the prime supplier who computes an "allocation fraction," which generally, must be used to guide the distribution of the gasoline. In computing the allocation fraction, the prime supplier

--forecasts the total supplies available for distribution during the following month,

--subtracts priority entitlements,

--subtracts State set-aside volumes, and

--divides the remaining supplies by the base period volumes of the remaining purchasers, thus arriving at the "allocation fraction," or the percentage of the base period volume that the purchasers will be entitled to receive.

The second attachment to my statement, a simplified DOE organization chart, shows the relationships of the principal components responsible for various aspects of the gasoline allocation program. Most are within DOE's Economic Regulatory Administration.

The Economic Regulatory Administration's Office of Petroleum Operations and its 10 regional offices are responsible for administering the allocation regulations.

There are two enforcement agencies involved. The Office of Special Counsel for Compliance covers the 34 major domestic refiners and the Office of Enforcement covers all other sectors of the petroleum industry.

Purchasers who have come into business since the base period are assigned base period volumes by the Office of Petroleum Operations in line with the base period volumes of comparable businesses nearby. Through the Office of Hearings and Appeals a purchaser or supplier experiencing gross inequity or serious hardship can request an exemption from the regulations or can appeal a decision made by the Office of Petroleum Operations.

DOE WAS UNPREPARED FOR A GASOLINE SHORTAGE

Now I would like to turn to our conclusion that DOE was unprepared to deal with the 1979 experience. We attribute this shortcoming to two principal causes. First, DOE's tendency has been to rely on crisis management in dealing with emergency situations--to depend on ad hoc responses, rather than well-planned approaches to anticipated problems. Second, since fiscal year 1977, DOE and its predecessor have budgeted for a scaled down regulatory program on the assumption that petroleum products would be decontrolled. The reality DOE faced was reduced staff

levels in the face of continued controls and increased staffing demands to deal with a highly volatile and critical supply problem.

We agree that some events and situations cannot be forecast, but this fact should not be used as an excuse for not planning for reasonably predictable situations. For example, workload processing and control systems, temporary staffing arrangements, and funding contingencies are types of situations that lend themselves to advance planning.

INADEQUATE PROGRAM IMPLEMENTATION

The problems associated with the allocation program were most visible at the Federal and State operations offices and DOE's Office of Hearings and Appeals, where individual requests for supplies and appeals of denied requests continued to pile up. The volume of requests and appeals is in itself a sign of program failure, but only a small indicator of the havoc and market impacts which resulted from the inadequate program implementation. Examples of the slow service and the hardship experienced by applicants are briefly sketched in the third attachment to my statement.

The gasoline shortage and the outdated regulations brought a surge of applications in 1979 for changes in seller/purchaser relationships and assignment of suppliers and base period volumes for new firms. The Office of Petroleum Operations' regional

offices were responsible for handling this workload, but because of large backlogs, Office of Enforcement staff were temporarily reassigned to assist all Office of Petroleum Operations' regional offices. Also, three Office of Enforcement regional directors were given the added responsibility of managing the Office of Petroleum Operations' regional offices in Atlanta, Chicago, and Denver. This, in turn, reduced the resources available to devote to surveillance and enforcement.

In the five regions we visited, we found problems in assembling, training, and organizing staff, and the lack of a management information system to control the work. The Office of Enforcement had to devise and install a work management system for the three Office of Petroleum Operations' regional offices it began to manage. The Office of Hearings and Appeals' field offices experienced similar difficulties in responding to the requests for exemptions or exceptions to the regulations.

Many applications received "rubber stamp" approvals, without verification of the information contained in the applications. Therefore, ERA had no assurance that the actions taken were warranted by the facts in the cases. Resolved cases were not reviewed to assure consistent and appropriate disposition.

PROBLEMS IN THE STATE SET-ASIDE PROGRAMS

As I noted earlier, the regulations give individual States a key role in implementing the allocation program. States electing

to participate in the program are required to follow the guidelines established by DOE. DOE set some general guidelines but has not provided the States with specific criteria and procedures for uniform administration of their set-aside programs.

Further, DOE did not adequately monitor or evaluate the program. It has taken a "hands off" approach.

States we visited generally had not effectively managed the State set-aside program during the 1979 emergency because of inadequate funding, inadequate and inexperienced staff, and inadequate facilities. They had not budgeted funds for the set-aside program and therefore did not have an organization in place and were not prepared to operate the set-aside program when the shortage hit.

The States' definitions of emergencies and hardships varied significantly, as did the criteria for receiving set-aside supplies. Lacking Federal definitions, the States were generally using vaguely worded definitions which allowed almost anyone to qualify for relief. The criteria did not appear adequate to insure that only applicants experiencing legitimate emergencies and hardships were provided set-aside supplies.

Set-aside supplies were distributed with inadequate documentation that an emergency or hardship existed, applicant information was not verified, and priority users whose requirements should have been met through normal distribution channels were receiving set-aside supplies.

States did not always allocate their entire set-aside volumes each month, and there were variations among the States in the instructions they gave prime suppliers for the distribution of released supplies.

AUDIT AND ENFORCEMENT PROBLEMS

DOE needs to establish an audit and enforcement program that will better assure program integrity and deter violators. DOE was not prepared to audit compliance with allocation regulations at the beginning of the 1979 shortage. Its Office of Enforcement did not begin its full-scale audit effort of small refiners until June, and of product resellers until August. Some of its staff were switched from their normal audit and enforcement activities to augment the Office of Petroleum Operations field staff.

The Office of Special Counsel for Compliance did not begin its allocation audit of major domestic refiners until May and did not complete 14 audits, even though in some instances there was preliminary evidence of potential violations that needed further investigation. It suspended the audits to meet the deadline for completing its primary mission, but it plans to complete nine of the audits in 1980 through the use of a contractor.

The results of the Office of Enforcement audit activity indicate widespread noncompliance by the industry. Even the limited work of the Office of Special Counsel found instances of apparent noncompliance. Other evidence we obtained supports this view.

DOE needs to develop a staffing plan which would allow a quick scale-up of its audit and enforcement program at the onset of a gasoline shortage, using fully developed audit programs. Likewise, there should be public awareness that there is a reasonable chance that violators will be identified, and that DOE will take whatever enforcement actions are necessary to remedy the violations, including assessing adequate penalties to encourage compliance.

CONCLUSIONS

We believe that necessary changes to the petroleum allocation program should be built around several desirable characteristics.

--Provisions for strong leadership and direction, placing the program responsibility at an organizational level high enough to insure maximum access to the authorities and powers needed to get the job done.

--Simplicity in design and operation which emphasizes timeliness and quality of service, consistent with program purposes.

--Recognition of the distinct, but complementary, roles and responsibilities of Government and industry. Unnecessary Government regulation and intervention should be avoided, and industry should be allowed to exercise its operational judgement within clearly defined and understood guidelines and regulations.

--Provisions for program monitoring to insure that desired results are being achieved and needed adjustments are made.

--Provisions for a strong compliance and enforcement program to insure that abuses and violations are detected and vigorously pursued.

In our report we recommended that the Secretary of Energy act immediately to revise the Mandatory Petroleum Allocation Regulations and insure successful implementation of the regulations during shortage periods. To this end we made 23 specific recommendations for changes and improvements to achieve the above-described desirable characteristics.

A few days ago DOE issued its comments on actions taken with respect to our recommendations, as required by the Legislative Reorganization Act of 1970. We have studied the comments, but have not had time to discuss the details with DOE. The general thrust of the comments is that DOE is in general agreement with our findings regarding the operational aspects of the allocation program and are taking a number of corrective measures.

DOE's response to some of our recommendations, however, leaves some room for concern about the adequacy of the actions. For example, a principal recommendation was to raise the responsibility for energy emergency management planning and implementation from the department level to the Office of the Secretary. Instead, it was recently placed within the Economic Regulatory Administration.

We intend, in the near future, to make a more detailed evaluation of DOE's actions on our recommendations.

This concludes my prepared statement. We would be happy to respond to questions.

ATTACHMENT I

ILLUSTRATION OF ALLOCATION FRACTION COMPUTATION AND ITS EFFECT ON DISTRIBUTION FROM REFINER TO RETAILER

ALLOCATION FRACTION COMPUTED BY THREE REFINERS

	REFINER A	REFINER B	REFINER C
FORECAST OF TOTAL AVAILABLE SUPPLY FOR THE COMING MONTH	700,000,000 GALS.	135,000,000 GALS.	20,000,000 GALS.
LESS:			
PRIORITY ENTITLEMENTS	(56,000,000)	(7,000,000)	(1,500,000)
STATE SET-ASIDE VOLUMES	(36,000,000)	(6,750,000)	(1,450,000)
AVAILABLE TO NONPRIORITY CUSTOMERS	610,000,000	121,250,000	28,050,000
DIVIDED BY BASE PERIOD VOLUMES (BPVs)	÷762,500,000	÷186,538,462	÷61,294,117
ALLOCATION FRACTIONS	0.80	0.65	0.425

ALLOCATION FRACTION COMPUTED BY FIRST WHOLESALE CUSTOMER

WHOLESALER D IS A CUSTOMER OF REFINERS A AND B AND HAS BASE PERIOD VOLUMES OF 1,000,000 AND 500,000 GALLONS, RESPECTIVELY, FROM THEM.

VOLUMES RECEIVED (EXCLUSIVE OF PRIORITY ENTITLEMENTS):

FROM REFINER A (1,000,000 GAL. BPV X 0.80)	800,000
FROM REFINER B (500,000 GAL. BPV X 0.65)	325,000
TOTAL	1,125,000
COMPOSITE ALLOCATION FRACTION (1,125,000÷1,500,000 GAL. BPV)	0.75

ALLOCATION FRACTION COMPUTED BY SECOND WHOLESALE CUSTOMER

WHOLESALER E IS A CUSTOMER OF BOTH WHOLESALER D AND REFINER C AND HAS BASE PERIOD VOLUMES OF 450,000 AND 300,000 GALLONS, RESPECTIVELY, FROM THEM.

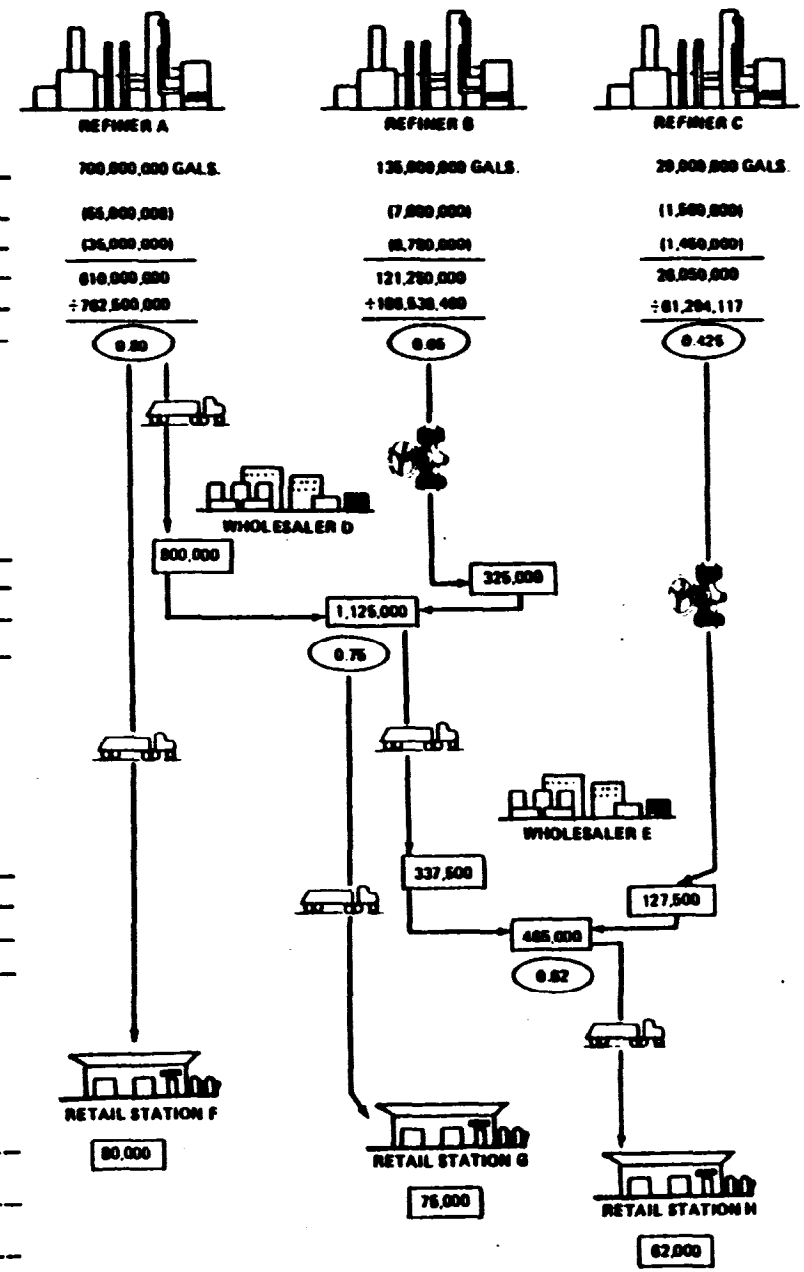
VOLUMES RECEIVED (EXCLUSIVE OF PRIORITY ENTITLEMENTS):

FROM WHOLESALER D (450,000 GAL BPV X 0.75)	337,500
FROM REFINER C (300,000 GAL. BPV X 0.425)	127,500
TOTAL	465,000
COMPOSITE ALLOCATION FRACTION (465,000÷750,000 GAL. BPV)	0.62

VOLUMES RECEIVED BY THREE RETAIL STATIONS

ALL THREE STATIONS HAVE BASE PERIOD VOLUMES OF 100,000 GALLONS

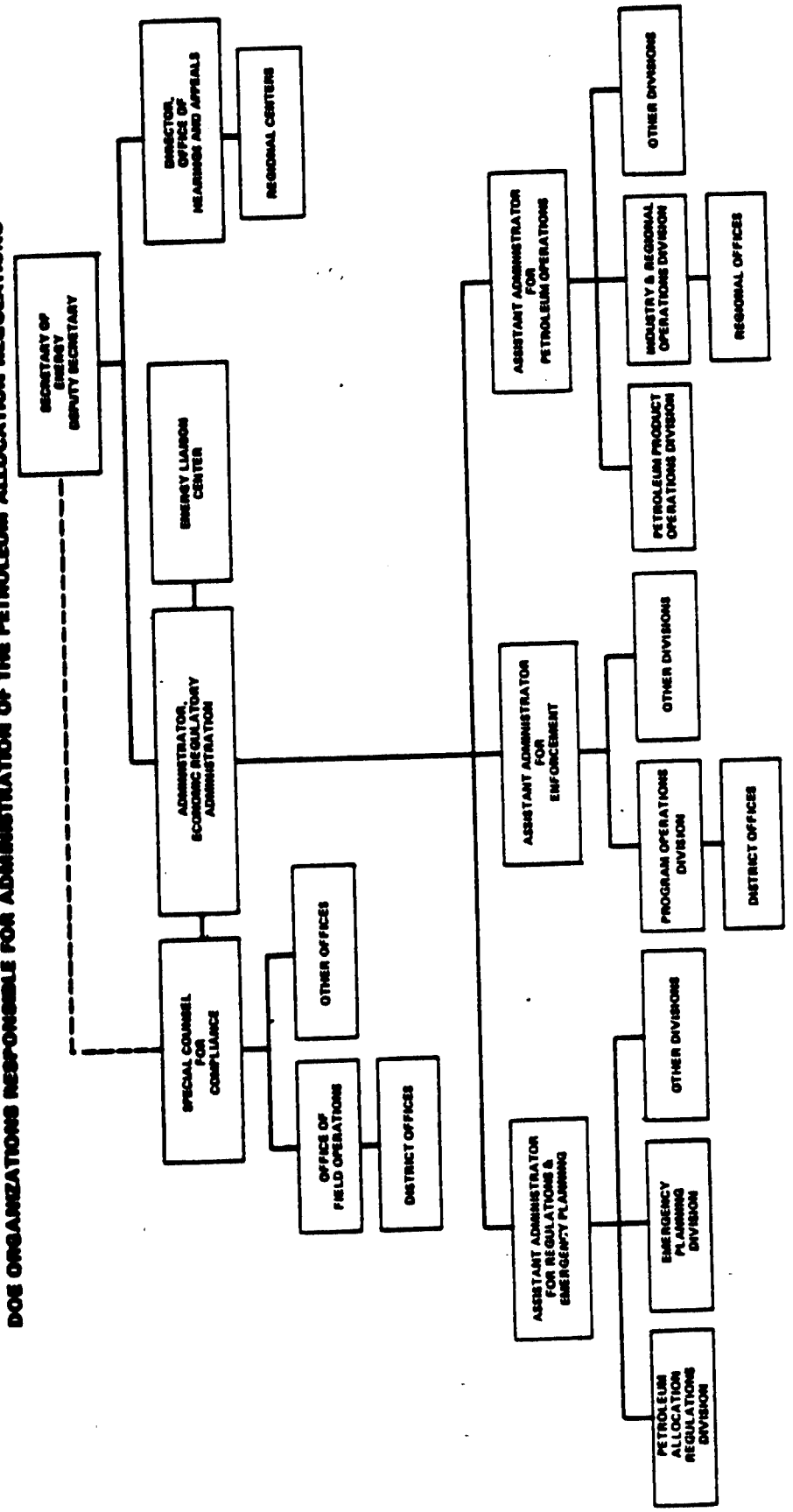
RETAILER F IS OWNED AND EXCLUSIVELY SUPPLIED BY REFINER A. IT RECEIVED (100,000 GAL. BPV X 0.80)	80,000
RETAILER G IS AN INDEPENDENTLY OWNED BRANDED STATION, RECEIVING ITS SUPPLIES FROM WHOLESALER D (100,000 GAL. BPV X 0.75)	75,000
RETAILER H IS AN INDEPENDENTLY OWNED, NONBRANDED STATION. RECEIVING ITS SUPPLIES FROM WHOLESALER E (100,000 GAL. BPV X 0.62)	62,000



Note: All Figures For Refiners, Wholesalers, And Retailers Are Hypothetical.

ATTACHMENT I

ATTACHMENT II



ATTACHMENT III

EXAMPLES OF HARDSHIP EXPERIENCED BY APPLICANTS FOR RELIEF FROM THE OFFICE OF PETROLEUM OPERATIONS

BOSTON - Region I

On February 9, 1979, DOE received a request from a wholesaler for an assignment of a base period volume for one of its stations that opened in January 1979. The case was first assigned on April 21, 1979, and then reassigned on May 18, 1979. DOE finally decided the case in mid-August 1979. At that time, however, under a regulation effective July 1, 1979, the wholesaler submitted a statement that his station was a major investment, which changed the status of the case. The case was still open on September 12, 1979. The wholesaler told GAO that they had to rely on the spot market for supply (when it was available) and they had also received some gasoline from the State set-aside program. He said that there were several occasions during the crisis when the station was closed because of the lack of supply. These periods usually lasted two or three weeks at a time.

CHICAGO - Region V

On March 13, 1979, DOE received a request from a retail station owner requesting assignment of a supplier and a base period supply volume. The station had opened under new management in May 1978 after being closed several years. DOE's order assigning a supplier and a base period volume were not issued until August 10, 1979.

DOE received a similar request on March 20, 1979. However, the assignment order was not issued until September 12, 1979 -- 176 days later.

KANSAS CITY - Region VII

On March 16, 1979, DOE received a request from a retail station owner that he be assigned a supplier and base period supply volume for a new station. DOE took almost six months to take final action. The case was not assigned until April 19, 1979. Final action was delayed until late August. The owner told GAO that during this time he had to obtain gasoline at higher prices on the spot market. He mentioned that action on this case improved after GAO inquired about the case.

On April 25, 1979, DOE received a request from a retail station owner that DOE assign him a supplier. DOE did not even begin work on the case until August 20, 1979. On two separate occasions--June 8, 1979 and July 5, 1979--contract personnel were available to work the case, but found this was one they were not allowed to work on. The station owner told GAO that although the station was intended to be open 24 hours a day, in May and June 1979 there were 6 to 8 weeks when it was closed, or in some cases open only 8 hours a day. He said that he obtained limited relief by buying on the spot market.

SAN FRANCISCO - Region IX

In San Francisco GAO found that the frequent changes in the base period served to frustrate DOE's efforts to resolve a case. A retail station that had been in operation since 1972, was closed in November 1977. It was remodeled and reopened in August 1978. On October 23, 1978, the operator applied to DOE for assignment of a supplier and base period volume. DOE determined in January 1979 that the dealer did not need assignment of a supplier or a base period volume because it had been in operation during the 1972 base period.

However, when DOE updated the base period effective March 1, 1979, the dealer's supplier said it could no longer provide gasoline because the station was not open during the new base period. In his appeal to DOE the dealer stated that he ran out of gasoline on March 20, 1979, and was forced to leave idle a $250,000 investment and lay off seven employees. Finally on June 11, 1979, DOE assigned the station the same supplier he originally had and established a base period volume.