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# REPORT BY THE Comptroller General OF THE UNITED STATES

## Department Of Energy Has Made Slow Progress Resolving Alleged Crude Oil Reseller Pricing Violations

The Department of Energy's Economic Regulatory Administration (ERA) continues to face significant problems in the crude oil reseller program which will hinder its efforts to resolve billions in alleged violations.

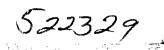
The problems include:

- --Loss of key and highly experienced ERA personnel because of continued uncertainty about the program's future.
- --Likelihood of companies contesting enforcement documents both administratively and in court, and the length of time that could elapse before ERA obtains ultimate judicial resolutions of contested issues.
- --Little success in negotiating settlements which were ERA's primary area of emphasis for fiscal year 1982.

In addition to the problems confronting the resolution of identified violations, ERA has no plans to conduct civil audits of the crude oil purchase and sales activities of most major refiners, in spite of earlier findings that some refiners were engaged in activities which potentially violated ERA's regulations.

GAO makes recommendations which are designed to bring a sense of stability and certainty to the crude oil reseller program, and thus encourage companies to cooperate with ERA in resolving alleged violations.







GAO/EMD-82-46 JUNE 1, 1982

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The Honorable John D. Dingell Chairman, Subcommittee on Oversight and Investigations Committee on Energy and Commerce House of Representatives

Dear Mr. Chairman:

On Octoper 14, 1981, and in subsequent agreements with your office, GAO was requested to examine the Department of Energy's (DOE) crude oil reseller program. You specifically asked that we examine the

--extent of civil and criminal violations,

--slowness in issuing proposed remedial orders,

--subpoena problems,

--adequacy of staffing,

--settlement efforts, and

--effect, on the program, of the December 14, 1981, reorganization of DOE's Economic Regulatory Administration (ERA), when the Office of Enforcement 1/ was incorporated into the Office of Special Counsel. 2/

We found that the situation in the crude reseller program has not improved significantly since we last reviewed the program over a year ago. Our findings and recommendations are summarized in this letter and discussed in more detail in appendix I.

<sup>1/</sup>The Office of Enforcement was responsible for civil audits of all companies other than the 35 major refiners.

<sup>2/</sup>The Office of Special Counsel was established in 1977 to audit the 35 major refiners pursuant to a recommendation by the Sporkin Task Force on Compliance and Enforcement and concurred in by the Subcommittee on Energy and Power, House Committee on Interstate and Foreign Commerce, because of their concerns that ERA was not providing sufficient audit coverage of these major refiners.

The crude oil reseller program was established to enforce the Emergency Petroleum Allocation Act of 1973 1/ (15 U.S.C. 751 et seq.) which required the President to establish regulations for controlling the allocation and selling price of crude oil and refined petroleum products. The President delegated the authority to establish these regulations to DOE and its predecessor agencies. DOE systematically deregulated most of the petroleum products over a period of time. Full deregulation occurred on January 28, 1981. ERA continues to enforce the program for violations that occurred during the regulation period.

#### SCOPE AND METHODOLOGY

We conducted our review at ERA's headquarters in Washington, D.C., and at field offices in Dallas and New Orleans. These offices provided major coverage of DOE's crude oil reseller audits. We discussed the program's progress, problems, and future plans with ERA officials and discussed audit approaches used to identify crude oil reseller violations. We were unable to fully evaluate ERA's future plans since they had not been completed by the time we finished our audit work in March 1982. We concentrated our efforts on updating the information contained in our March 1981 report entitled "Department of Energy Needs to Resolve Billions in Alleged Oil Pricing Violations" (EMD-81-45, March 31, 1981).

We also reviewed the status of individual audit cases and statistical information in ERA's computerized case management system. However, during our review, ERA reorganized and switched from its automated data system to a manual data system, and, as a result, we found it more difficult to obtain even basic statistical information about the crude reseller program. Despite our repeated requests for reliable data, ERA furnished data which in some instances was of questionable reliability. We plan to follow up on this matter in a separate review.

Also, in May 1982, while this report was in final processing, ERA initiated another organizational change which, if approved by the appropriate DOE officials, would eliminate the Office of Special Investigations (established to investigate the potentially willful violations of DOE's regulations). If this change is made, we also plan to include this matter in our separate review because of the impact it could have on the successful completion of the crude reseller program.

1/The Act expired on September 30, 1981.

Our audit work was conducted in accordance with our current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

#### RESULTS OF PAST WORK

In our March 1981 report, we stated that ERA's former Office of Enforcement had established a crude oil reseller program to audit the compliance of crude oil resellers (over 400 companies) with the petroleum pricing regulations. The Office of Enforcement gave crude oil reseller audits its second highest priority, next only to investigations of potentially willful violations. We reported that ERA expanded its audit coverage of crude oil resellers and had improved its timeliness in completing audits since 1979, but had very little success in resolving the alleged violations.

When ERA's audits reveal potential civil violations of the pricing regulations, DOE may either issue an administrative order, institute legal action in a court of law (15 U.S.C. 754 (a)(1)), or negotiate a settlement with the company when it is in the public interest to do so. ERA generally tries to negotiate a settlement with the company. If a settlement is not achieved, DOE formerly initiated an administrative order by issuing a notice of probable violation against the company followed by a proposed remedial order, if appropriate. The present procedure is to go directly to the proposed remedial order stage. When potential criminal violations are found, it is DOE's policy to refer the criminal aspects of the case to the Department of Justice for possible prosecution.

As of December 31, 1980, the Office of Enforcement had alleged crude oil reseller violations of \$675 million in issued or drafted notices of probable violation. These documents identified violations in three key areas

--miscertifying crude oil sold,

--failing to provide historical and traditional services (layering), and

--improperly pricing crude oil sold.

Prior to the December 1981 reorganization, the Office of Special Counsel concluded that only 6 of the 35 major refiners were crude oil resellers, and Special Counsel expected to charge 2 of the 6 with crude oil reseller violations.

Our March 1981 report also pointed out that although ERA's former Office of Enforcement had issued notices of probable violation against many crude oil resellers, it had not taken the necessary administrative or judicial steps to resolve the alleged civil violations--issued proposed remedial orders or filed suits in court. ERA had negotiated settlements (consent orders) with 10 crude oil resellers, receiving about \$32.9 million in refunds for violations and about \$4.7 million in civil penalties. All put 2 of the 10 consent orders (about \$31.8 million in refunds) involved companies which were the subject of the Department of Justice's criminal prosecutions.

#### CURRENT PROGRAM STATUS SHOWS LITTLE IMPROVEMENT

Our current review shows that the situation has not improved significantly since our March 1981 report. Furthermore, it will not improve, regardless of the ambitious objectives ERA set for fiscal year 1982, without a firm commitment and concerted actions on the part of DOE to resolve the alleged violations identified in crude reseller audits. Particularly, DOE must be willing to continue the crude reseller program long enough to obtain the data necessary to disclose potential willful violations, including evidence of involvement by major refiners. However, the necessary work must be done expeditiously because of the 5-year statute of limitations on willful violations and the increasing difficulties caused by the passage of time in resolving alleged violations.

More specifically, we found that:

--The number of audits undertaken and the number of violations alleged have increased since our March 1981 report. In May 1981, the Acting Director of the Crude Oil Reseller Program estimated that potential violations could amount to about \$4.7 billion, including 25 percent interest (over \$3.7 billion without interest). However, ERA's success at resolving alleged violations has not improved; for example, ERA's decontrol workplan of March 1981 had a primary objective of issuing proposed remedial orders or consent orders on 84 top priority cases, including 24 crude oil resellers, before September 30, 1981. Between March 1981 and March 1982, however, only three proposed remedial orders, one of which has been issued as a remedial order, and one consent order have been issued to crude oil resellers.

- --ERA's audit coverage of the sales and purchases of crude oil by major refiners has been inadequate, in spite of a study by the former Office of Enforcement which indicated major refiners might be involved in illegal crude oil reseller activities.
- --ERA has experienced decreasing company cooperation and as one consequence, DOE had 92 subpoenas outstanding as of April 30, 1982, of which 41 were related to special investigations.
- --ERA's staff morale has continued to suffer because of uncertainties about the program's future and because experienced auditors have left ERA's employment, or have been removed from responsible management positions through ERA's reorganization.
- --The reorganization removed the position of Director, Crude Oil Reseller Program, thus lessening program coordination.
- --ERA has had little success in negotiating settlements of alleged violations with companies.
- ERA's objectives for fiscal year 1982 are to .
- --resolve as many cases as possible through negotiated settlements,
- --have all other cases ready for litigation or in litigation by September 30, 1982, and
- --refer all potential willful violations to the Department of Justice for prosecution.

The administration is requesting \$13.5 million for the ERA enforcement program for fiscal year 1983, a reduction of \$23 million from the fiscal year 1982 funding level. Concommitantly, the program staffing level would be reduced by about 500 positions, from 770, as of October 17, 1981, to 263 full time equivalent positions during fiscal year 1983. Regarding the "other than major refiner" category, which includes the crude reseller program, the proposed budget provides for only 37 full time equivalents for fiscal year 1983, compared to the 216 full time equivalents for fiscal year 1982. As of October 31, 1981, the crude reseller program had a work force of 77 personnel.

#### CONCLUSIONS AND RECOMMENDATIONS

The crude oil reseller program has identified significant civil and potential willful violations of ERA's petroleum pricing regulations. It has been acknowledged by ERA officials

as the area having the greatest abuses of the pricing regulations. However, because of the significant problems highlighted above, the program has very little momentum for resolving these violations, and we do not believe that ERA can meet its objectives for fiscal year 1982.

If ERA does not substantially meet its 1982 objectives, its proposed budget of \$13.5 million cannot reasonably be expected to provide adequate resources to effectively conclude the crude reseller program and to provide adequate coverage of the purchase and sales activities of major refiners. As stated previously in our March 1981 report, we believe the crude oil reseller program should be concluded in such a way as to (1) be fair to those that abided by the regulations, (2) provide equal enforcement to those that did not, and (3) assure that violators are not permitted to retain illegal gains.

To properly conclude the crude oil reseller program, we believe ERA should reestablish the position of Director, Crude Oil Reseller Program, with a highly experienced official to provide centralized management and coordination for the field program. The Director, with the full backing of the ERA Administrator, should place top priority on resolving subpoenas, finishing audits, and pursuing all cases to the proposed remedial order stage in an aggressive manner. Such actions would, we believe, help bring a sense of stability and certainty to the crude oil reseller program and make it clear to affected companies that the Government intends to follow through on ERA's audit findings, collect overcharges, and prosecute willful violators. ERA should make it clear that stalling and failing to cooperate will not benefit the companies. In this way, the program administrators will be able to negotiate with the companies from a position of strength. If negotiations fail, the companies should be assured that they will either be subjected to DOE's administrative process, or sued in court. We believe that such actions will also have a beneficial effect on staff morale and show experienced employees that their efforts will not be wasted. It may also encourage some of them to remain with the program to its conclusion.

Accordingly, we recommend that the Secretary of Energy:

- --Direct the Administrator, ERA, to reestablish the position of Director, Crude Oil Reseller Program, and fill it with a highly experienced official.
- --Direct the Administrator, ERA, to provide for audit coverage of selected major refiners' crude oil sales and purchase activities, based on the implications of the former Office of Enforcement's study of crude oil pipeline transactions, and to assess the legality of the refiners sales and purchase transactions with crude oil resellers.

At your request, we plan no further distribution of this report for 30 days after issuance or until you release it. Also at your request, we did not obtain agency comments on this report. We did discuss the factual information contained in this report with ERA officials.

Sincerely yours,

Howlan Yulton

for Comptroller General of the United States

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#### ABBREVIATIONS

- DOE Department of Energy
- ERA Economic Regulatory Administration
- GAO General Accounting Office

### ERA reorganization and changes in operating procedures

In December 1981, the Secretary of Energy approved a reorganization of ERA as proposed by the ERA Administrator. A primary change was the integration of the Office of Enforcement into the Office of Special Counsel. The Administrator stated that such integration of functions would (1) avoid a substantial amount of administrative duplication and enable the staff to concentrate as many people as possible on actual enforcement work, (2) facilitate uniform application of regulatory interpretation and enforcement philosophy, and (3) communicate to the industry and to the public ERA's determination to concentrate on litigating and settling cases during the next year.

Because crude reseller cases are reaching the litigative stage, the Administrator believed more emphasis was needed on the legal aspects of cases rather than the audit aspects. As a result, in reorganizing ERA, he has put attorneys in charge of two of the field offices that deal primarily with crude resellers. According to the Administrator, an auditor (although less experienced in crude reseller audits than the former director) was left in charge of the Dallas field office because the Dallas office handles many cases other than crude resellers.

As part of the reorganization, ERA created the Office of Compliance Operations. This office's functions originally included analyzing and evaluating the evidence and legal support for all cases with the aim of establishing priorities for resolving the cases. Because of the expertise needed to conduct such evaluations and the critical nature of this function, the 10-person professional staff assigned to the office was comprised of five GS-15s, three GS-14s, and two GS-13s, a relatively high grade structure. However, because of the ERA Administrator's decision to have the field offices establish their own case priorities (see p. 12), the compliance office is now primarily a service organization that collects information for use by the Office of Special Counsel. As of April 26, 1982, two of the GS-15s had been reassigned to other DOE offices. We believe the grade structure for this organization is top-heavy considering its assigned duties.

ERA headquarter's officials stated that the reorganization will also include the closing of some field offices, but that offices with active crude oil reseller cases and experienced crude oil reseller auditors will not be affected by these closures.

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Also, in October 1981, a special task force was appointed by the ERA Administrator to recommend actions that need to be taken to make the crude reseller enforcement program more effective. Some of the recommendations made by the task force in January 1982 are summarized as follows:

- --ERA personnel experienced in the crude reseller program should be encouraged to remain with DOE until at least September 30, 1982, by assuring them that crude reseller field offices will remain open until that time.
- --DOE'S General Counsel should quickly review legal positions regarding several regulatory issues affecting audits and the drafting of enforcement documents.
- --Subpoenas for which crude oil resellers have failed to comply with ERA's requests for data, should be enforced on a high priority basis.
- --The Office of Special Investigations should continue to place the highest priority on its current investigations into possible deliberate manipulations of crude oil tiers by certain major refiners and crude oil resellers so that potential referrals to the Justice Department can be made as soon as possible.
- --Proposed remedial orders should be issued, where possible, in future crude reseller cases, and, where appropriate, the Department of Justice should be requested to file a complaint directly in Federal district court.
- --Continue to resolve cases by consent settlements where possible, and authorize crude reseller field offices to enter into settlements with guidance from the Office of Special Counsel.
- --Further evaluate the program's progress by the end of June 1982.

We generally agree with the above task force recommendations, but, to be effective, they should be implemented quickly and aggressively. We are concerned, however, about the loss of some key and highly experienced personnel associated with the reorganization. The loss of experienced auditors, as previously discussed on page 6, is especially troublesome. Audit capability is essential through the proposed remedial order issuance stage. Even if replacements are found, training them would result in a drop in efficiency.

Examples of the loss of key and experienced personnel include the former Director of the Office of Enforcement's Dallas District Office, and Enforcement's former Crude Oil Reseller Program Director. The former Dallas District Office Director has

#### APPENDIX I

been transferred to DOE's Office of Inspector General. The Director's position was abolished when the Office of Special Counsel absorbed the Office of Enforcement. The Crude Oil Reseller Program Director position has also been eliminated. The former Acting Director now works only on crude oil reseller cases in the New Orleans office. Field personnel told us that the Dallas, Houston, and Tulsa offices, which specialize in crude oil reseller cases, now operate autonomously. They formerly coordinated their work closely through the Crude Oil Reseller Program Director to identify the interrelationships of various crude oil resellers operating in the different ERA field districts--several companies buying from and selling to each other in what is referred to as a "daisy chain."

The ERA Administrator said that the reorganization was not intended to limit the coordination between the various crude reseller offices. He said the reseller offices are not prohibited from coordinating with each other if they feel it is necessary; however, he does not believe a formal coordination system is necessary because the daisy chain activity has been exaggerated. Yet, ERA officials have long acknowledged that the greatest abuse of the pricing controls took place in the crude oil reseller area. For this reason and because of the complex and common issues encountered by the crude reseller field offices, we believe close coordination is important.

#### Case evaluations

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The ERA Administrator told us that when he took office he knew very little about the enforcement program and that basic information on numbers and status of cases was not in a consolidated form. Shortly after taking office, he had his Special Counsel develop a form to obtain individual evaluations of all open audit cases. The purpose of this exercise was to obtain information on such things as the case load, status of the cases, work remaining to be completed, dollar amounts involved in the cases, and the audit and legal strength of the cases. The form included, among other things, information on

--type of case - crude oil reseller, producer, etc.,

--status of the case - notice of probable violation, proposed remedial order, etc.,

--violation amounts,

--availability of cognizant audit and legal personnel,

--referrals to special investigations, and

--status of settlement efforts.

He also requested the cognizant field personnel to rate the cases for audit support and legal strength, on a scale of 1 to 5 "a very good case" to "a very bad case," respectively.

In early October 1981, a 2-day meeting was held in Washington, D.C., with ERA's field and headquarters officials to discuss the purpose of the form and how to fill it out. No written documentation was prepared on the results of the meeting. ERA's field personnel told us that the field offices virtually halted their audit and enforcement processes for about 6 weeks (October 5 to November 14, 1981) to prepare these evaluations.

The ERA Administrator originally planned, as previously discussed, to have the ERA's Office of Compliance Operations evaluate the forms and provide the field staff with case priorities for concluding the ERA enforcement program. However, the Administrator decided that because of the diversification of cases involved and the reseller expertise of the field staff, that each field office should establish its own priorities. On December 15, 1981, the new heads of the ERA field offices were told in a meeting with the ERA Administrator and other ERA headquarter's officials that each field office was responsible for establishing its own case priorities.

Even though the forms did not serve their primary purpose, the ERA Administrator said that they did serve as a tool in managing the cases. He said the forms provided him with essential information such as the case load, what cases needed more work, and what cases were involved in the same legal issues. After the cases were categorized by legal issues, the Office of Special Counsel, in close coordination with the Office of General Counsel, selected cases from each category for processing to the proposed remedial order stage. The Administrator said that the selections of such cases are very important to the crude oil reseller program because they will give ERA its legal direction and provide some indication of how successful ERA might be in resolving these cases.

While we agree that issuing proposed remedial orders for crude oil reseller cases is a critical and important step, we doubt that the evaluation forms were essential to proceed with this step, particularly when considering that the crude reseller program was virtually shut down for 6 weeks to prepare the forms. It appears to us that the primary purpose of the evaluation forms was to establish case priorities. However, this function was not completed at headquarters, and it appears that little use was made of the evaluation forms other than to obtain general information about the program which was already available in ERA's computerized case management system.

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### Continued uncertainty about the program

The uncertainty as to the future of the program continues to plague the management and operation of the crude oil reseller program, especially at the field office level. This uncertainty is fueled, in part, by public statements attributed to the Administrator which are apparently having a negative effect on the program. The Administrator told us that this uncertainty has arisen because of (1) the complexity of the enforcement program, its regulations, and the processes for recovering overcharges and prosecuting violators and (2) the unfamilarity of media representatives with the program. He stated that he has tried to make it clear that the Government intends to recover overcharges and to prosecute violators. He said he has tried to explain some of the complex problems, but reporters, attempting to simplify the material for their readers, have misinterpreted his intentions, quoted him out of context, and misquoted him.

The following are examples of such quotes attributed to the ERA Administrator:

"The previous administration tried to make a strong case that the oil companies gouged the public. Frankly, we found no evidence of that." 1/

"We'll actually work a higher figure through settlements than you might get in court, but litigation would be preferable because we believe most of these laws and regulations would be thrown out in court. From an academic standpoint, it would be good to show how irrational and how flimsy most of this act was." 2/

Furthermore, an oil industry publication <u>3</u>/ stated that the Administrator said he had reports that some auditors and regional managers are being unreasonable in settlement negotiations and that ERA would rather settle than litigate. The article stated that the Administrator had said if a company was having trouble settling an audit on "reasonable" terms, it should call him personally. The article then provided the Administrator's telephone number.

I/Dallas Morning News, November 4, 1981.

2/Oklahoma City Times, December 11, 1981.

3/Oil Express, November 16, 1981.

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ERA field personnel told us that such public statements attributed to the Administrator about ERA's intentions have inhibited their ability to complete on-going audits, and the potential demise of DOE has given the companies hope that the alleged violations will be dropped. Under these conditions, they stated, the companies see no incentive for cooperating with ERA. ERA crude oil reseller auditors told us that the companies' willingness to cooperate had diminished as is evidenced by the increasing need for subpoenas and the lengthening periods required to enforce subpoenas. They said that several companies have refused ERA auditors access to their records because they understood the Administrator to say that audits would be stopped in order to wrap up the enforcement program.

#### CONCLUSIONS

The crude oil reseller program has identified significant civil and potential willful violations of ERA's petroleum pricing regulations. However, because of the problems discussed in this report, the program has very little momentum for resolving these violations and we do not believe that ERA can meet its objectives for fiscal year 1982. If ERA does not substantially meet its 1982 objectives, its proposed fiscal year 1983 compliance budget of \$13.5 million cannot reasonably be expected to provide adequate resources to effectively conclude the crude reseller program and to provide adequate coverage of the purchase and sales activities of major refiners because it only provides for 263 full time equivalent positions compared to the workforce level of about 770 in October 1981.

ERA faces numerous and significant problems in the crude reseller program which will have detrimental effects on its ability to resolve the reseller violations. Some of the principal problems are as follows:

- --The continued uncertainty about the future of the program has encouraged some companies not to cooperate with ERA, and has resulted in the loss of key and highly experienced personnel.
- --It is quite likely that companies will contest ERA's alleged violations in administrative litigation and in court after enforcement documents are issued. Consequently, it could be years before ERA obtains ultimate judicial resolutions of these cases.
- --Negotiated settlements, ERA's primary area of emphasis for fiscal year 1982, have generally met with little success.

In addition to the prospect that ERA's fiscal year 1982 objectives are not likely to be met, ERA has no plans to conduct civil audits of the purchase and sales activities of most major refiners, in spite of the former Office of Enforcement's findings that some refiners were engaged in crude oil reseller activities which potentially violated ERA's regulations.

We believe that the crude oil reseller program should be phased out in such a way as to be fair and equitable to those that abided by the regulations, to provide equal enforcement to those that did not, and to assure that violators are not permitted to retain illegal gains. Furthermore, to expedite crude reseller cases, the ERA Administrator and the Department's Office of General Counsel should continue working together to resolve the legal issues involved with such cases.

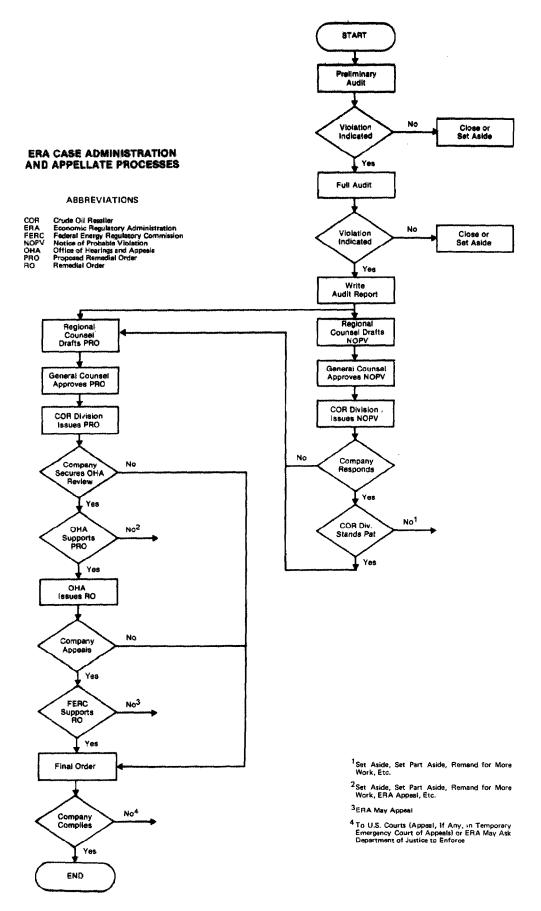
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#### RECOMMENDATIONS TO THE SECRETARY OF ENERGY

To properly conclude the crude oil reseller program, and to demonstrate to the public and affected companies that the Government is committed to follow through on ERA's audit findings, collect overcharges, and prosecute willful violators, we recommend that the Secretary of Energy:

- --Direct the Administrator, ERA, to reestablish the position of Director, Crude Oil Reseller Program, and fill it with a highly experienced official.
- --Direct the Administrator, ERA, to provide for audit coverage of selected major refiners' crude oil sales and purchase activities, based on the implications of the former Office of Enforcement's study of crude oil pipeline transactions, to assess the legality of the refiners sales and purchase transactions with crude oil resellers, where not precluded by existing global settlements.

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#### SUBPOENAS ISSUED-AGING REPORT AS OF DECEMBER 1, 1981

#### Completed subpoenas

	Months to completion					
Year issued	<u>1-3</u>	<u>4-6</u>	<u>7-12</u>	13-18	19 and over	Total
Closed cases						
1981	9	3	2			14
1980	9	15	1		-	25
before 1980	10	3	T	1	-	$\frac{15}{54}$
Subtotal	28	21	4	1		54
Open cases						
1981	27		1	-	-	28
1980	14	5		-		19
before 1980	15		-	1	-	$\frac{16}{63}$
Subtotal	56	5	1	1		63
Total completed	84	<u>26</u>	5	_2		<u>117</u>

#### Outstanding subpoenas

		MC	onths	outstand	ing	
1981	16	19	49		-	84
1980	-	~		6	2	8
before 1980	_					-
	_					
Total outstanding	<u>16</u>	19	<u>49</u>	_6	2	92

Total subpoenas issued

1981 1980 Þefore 1980	126 52 <u>31</u>
Total	209

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#### APPENDIX I

#### DEPARTMENT OF ENERGY HAS MADE SLOW PROGRESS RESOLVING ALLEGED CRUDE OIL RESELLER PRICING VIOLATIONS

#### EXTENT OF CIVIL AND CRIMINAL VIOLATIONS

ERA officials acknowledged that the crude reseller regulations were the most susceptible to abuse during the price control period. Since our March 1981 report, ERA has continued to pursue the crude oil reseller audits. As of March 1982, ERA had opened 417 civil audits and special investigations--an increase of 220 over the 197 audits and investigations discussed in our March 1981 report. The following chart shows the disposition of these cases.

#### Status of crude oil reseller cases as of March 31, 1982

Open cases

On-going audits Audits completed but no compliance documents drafted Compliance documents issued or drafted (note a)	137 7 <u>97</u>
Total open cases	241
Closed cases	
With violations (note b) Currently with the Department of Justice Without violations Other closed cases (note c)	41 26 38 71
Total closed cases	176
Total cases	417

Source: Economic Regulatory Administration

a/Includes drafted proposed remedial orders or drafted/issued notices of probable violation.

D/ERA classifies a case closed when a proposed remedial order is issued.

<u>c</u>/Cases closed for other reasons including cases where the company was not a crude reseller, cases consolidated with other audits, etc.

Of the 417 cases, 81 had been referred to DOE's Office of Special Investigations as possible, willful (criminal) violations. Of the 81 cases, 29 have been referred to the Department of Justice for criminal prosecution.

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ERA field officials told us, in December 1981, that the former Office of Enforcement had formalized nearly \$1 billion of alleged violations in drafted or issued compliance documents, and field officials estimated that additional violations of \$3.7 billion 1/ existed in incomplete and ongoing audits. More current information was not available regarding incomplete and ongoing audits. ERA field officials explained that many companies have been charged with or are suspected of pricing, certification, and layering violations, each of which addresses the same sales transactions. The ERA Administrator told us that for this and other reasons the alleged violation amounts were overstated. However, ERA field officials told us that to avoid the possibility of double or triple counting in the estimates of the total crude oil reseller violations, they based the net violation for each company only on the largest of the individual violation amounts. For example, if a company was charged with a certification violation of \$50 million and a layering violation of \$100 million on the same sales transactions, the company's net alleged violations would be \$100 million, not \$150 million. On a limited test basis, we verified that such double counting was not occurring.

The following chart illustrates the status of administrative actions as of March 1982 for the crude reseller program.

#### Status of administrative actions as of March 31, 1982

	Number of_cases	Alleged violation amounts (millions)	
Notices of probable violation - issued Proposed remedial orders - in draft	52 65	\$ 529.6 478.7	
Total	117	\$1,008.3	

The Office of Special Counsel did not set up separate groups to conduct civil audits of major refiner's crude oil sales and purchase activities, but in a few instances, it performed these audits as a part of its refinery operation audits. Special Counsel officials told us these crude oil reseller audits were performed at only 5 of the 35 major refiners. Special Counsel did not issue notices of probable violation or proposed remedial orders in any of these cases. Instead, Special Counsel has generally attempted to resolve any crude oil reseller violations by

<sup>1/</sup>In May 1981, the former Acting Director, Crude Oil Reseller Program, estimated the total potential violations, plus 25 percent interest, to be about \$4.7 billion (over \$3.7 billion without considering interest on the violation amounts).

including them in negotiations of comprehensive consent orders (termed "global" settlements) whereby a single settlement is negotiated to resolve all company violations, regardless of type.

#### INADEQUATE COVERAGE OF MAJOR REFINERS' SALES AND PURCHASES OF CRUDE OIL

As noted above, the Office of Special Counsel did not conduct civil audits of the crude oil sales and purchase transactions for most (30 of 35) of the major refiners. Office of Special Counsel field officials told us that they did not audit these companies for possible crude oil reseller violations because the companies had not established their own reseller entities as profit-making ventures. Instead, Special Counsel viewed the major refiners' crude oil sales and purchase activities as "accommodation sales" and "inventory adjustments" to facilitate acquisition of proper qualities and quantities of crude oil for refining purposes. Special Counsel officials said that, on this basis, Special Counsel:

- --Stopped its audits of the major refiners' crude production activities at the point where the refiners transacted the "first sale" even if the first sale was to an affiliated marketing entity. Special Counsel did not audit the sale of the same crude oil to nonaffiliated entities, i.e., crude oil resellers, to determine if the sales complied with pricing regulations.
- --Did not attempt to verify the accuracy of certifications when the major refiner purchased crude oil. Special Counsel merely checked to ensure that certificates accompanied purchases.
- --Did not assess the reasons for crude oil sales or evaluate the legality of potential benefits accruing to the major refiners as a result of their crude oil sales and purchases.

Special Counsel did not conduct civil audits of these aspects although they were aware of the findings of the former Office of Enforcement's July 1980 study of crude oil reseller activity in various crude oil pipelines. The study showed that, among other activities, some major refiners were selling significant volumes of crude oil certified as lower tier and upper tier to crude oil resellers and purchasing back crude oil at higher prices, certified in many instances as stripper well or foreign crude.

Enforcement's report, which was given to the Department of Justice for possible criminal investigation, showed that since 1976, the volume of title transfers in the pipelines (in-line transfers) had increased significantly, particularly when compared to the volume of transfers during unregulated periods. The report stated that this increased volume of pipeline transactions appeared to correspond directly with the increase in the number of new crude oil resellers which did not perform those services generally associated with historical, i.e., pre-May 15, 1973, resellers, such as gathering and transporting crude oil purchased from producers.

Enforcement's study indicated that, to the contrary, the new resellers generally bought, sold, or exchanged crude oil made available by refiners (including major refiners) for in-line transfer on the pipelines involved. In earlier periods, this crude oil was transferred directly to the refiner with few or no in-line transfers. The report stated that unlike the historical in-line transfers to accommodate distressed refiners, the more recent activity appeared to be at least partially designed to provide some refiners with particular crude oil certifications which could maximize benefits under the entitlements program. 1/ (ERA auditors believed that the benefit arose because refiners were probably buying the stripper well and foreign certified crude oil at a discount price under the monthly national weighted average cost per barrel of crude to refiners, used by DOE to compute the entitlement price.)

In just such a case, a major refiner asked DOE's General Counsel for an interpretation on the legality of a contractual agreement which obligated the refiner to sell a volume of properly certified lower and upper tier crude oil to another company and to buy in the same time period an equal volume of properly certified stripper well crude oil in exchange. The refiner stated that these transactions would result in reduced crude oil costs because the refiner claimed that the stripper well crude oil to be received would not entail an obligation to purchase entitlements, as the refiner would be required to do if it refined the lower and upper tier crude oil sold initially. Instead, the refiner would be allowed to sell entitlements.

General Counsel responded, in effect, that firms entering into a purported matching purchase and sale or exchange transaction in which a factor other than (crude oil) quality or location is given effect in the computation of the exchange ratio (for example, to reduce the refiners' obligations to purchase entitlements) may be actively engaged in unlawful conduct.

<sup>1/</sup>The purpose of the entitlements program was generally to equalize U.S. refiners' crude oil costs by distributing the benefits of access to lower-priced domestic crude oil proportionately to all domestic refiners through a system of monetary rather than physical transfers.

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While Enforcement's pipeline study indicated that some major refiners were engaged in precisely this kind of activity, Special Counsel did not follow up with audits to determine if violations existed. DOE officials told us that in instances where crude oil sales were not specifically exempted by terms of the global settlements entered into by Special Counsel, ERA is not permitted to follow up for the period covered by the settlement, unless the major refiners had defrauded ERA or deliberately misrepresented significant facts during the audits. As of September 30, 1981, 16 of the 35 major refiners had entered into global settlements with ERA.

#### SLOWNESS IN ISSUING PROPOSED REMEDIAL ORDERS

DOE has lengthy and time consuming case administration and appellate processes. (See app. II.) In March 1981, after decontrol occurred, the former Office of Enforcement established its decontrol workplan objectives for fiscal year 1982. At that time, Enforcement had 222 crude oil reseller cases in its inventory of 1,108 active cases. Enforcement officials placed top priority on 84 open audits involving \$1.6 billion in alleged violations. These 84 audits included 24 crude oil reseller cases involving \$738.7 million in alleged violations. Enforcement's objective was to issue proposed remedial orders or consent orders on each of these cases before September 30, 1981. Between March 1981 and March 1982, however, ERA had issued only three proposed remedial orders, one of which has been issued as a remedial order, and one consent order to crude oil resellers.

Also, as of March 31, 1982, Special Counsel had 52 notices of probable violation outstanding, and had 65 proposed remedial orders in the draft stage. In an attempt to streamline that portion of the administrative process under his control, the ERA Administrator has recently instituted the policy of issuing proposed remedial orders without going through the notice of probable violation phase. Based on past experiences, as discussed in our March 1981 report, it is quite likely that the companies will contest ERA's claims when these enforcement documents are issued. The resulting administrative litigation will probably be very time consuming and, in many cases, ultimately end up in court. Consequently, it could be years before ERA obtains ultimate judicial resolutions of these cases.

In January 1982, the ERA Administrator stated that part of this problem was internal because his office had not received official guidance from the Office of General Counsel on the interpretations of a few sections of DOE's regulations. The Administrator acknowledged, however, that the Office of General Counsel had provided ERA with some legal interpretations in concurring with past ERA notices of probable violation.

In addition, DOE's Deputy General Counsel for Enforcement and Litigation sent a memorandum, dated March 4, 1982, to the ERA Administrator reaffirming the General Counsel's position on the

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legal concepts involving three areas of the regulations. Furthermore, ERA and General Counsel attorneys have been working closely together, which has led to the issuance of two proposed remedial orders against crude oil resellers in mid-March 1982.

#### SUBPOENA PROBLEMS

ERA has experienced decreasing company cooperation and has resorted to increasing use of subpoenas and lengthy subpoena enforcement efforts by the Department of Justice to obtain company records for audit. As of April 30, 1982, ERA had 92 subpoenas outstanding against crude oil resellers of which 41 were related to special investigations.

Appendix III illustrates the growing problem ERA has had in getting needed records from companies. It shows that more than twice as many subpoenas were issued in 1981 as in 1980 (126 versus 52), and 1980 activity was higher than prior years' activity (52 versus 31). Furthermore, twice as many 1981 subpoenas were outstanding on December 31, 1981, as were completed during 1981 (84 outstanding versus 14 completed on closed cases and 28 completed on open cases). Forty-nine of the 84 subpoenas had been outstanding from 7 to 12 months. ERA's headquarters officials were unable to update this information in the appendix III format.

Although the number of audits has increased, this problem has largely grown for two other reasons. First, as discussed in our March 1981 report, because of the perceived ambiguity surrounding some of the regulations and the enormous dollar value at stake, some oil companies have chosen to resist ERA. Second, according to ERA officials, the perception of many companies that the program will soon be terminated, has encouraged some companies to withhold their cooperation from ERA.

#### ADEQUACY OF STAFFING

ERA enforcement activities have suffered from low staff morale over the uncertainty of the administration's intent regarding job security and the disposition of alleged violations. Many experienced people have left ERA employment and ERA managers expect many more to leave as they find other jobs. This uncertainty has been increased unnecessarily by premature announcements of field office closings and a general lack of communication from the ERA Administrator to field personnel about the future of the program.

As of October 31, 1981, ERA had 77 personnel assigned to the crude oil reseller program, an increase of 11 over those assigned on October 1, 1980. However, this increase did not represent an improvement because 37 of the 77 personnel were assigned from other ERA programs, and the vast majority of them had no crude oil reseller audit experience. Also, 26 employees have left the reseller program. Fifteen of the 26 employees had been with the program for at least 1 year, and

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12 of the 15 had GS grades of 11 or higher, including the audit director of the Tulsa office. Because of the complexities of the reseller program, experience in handling such cases is essential to their timely resolution.

#### SETTLEMENT EFFORTS

ERA has had little success at negotiating settlements of alleged violations with companies. Most consent orders are the result of defendants agreeing to settle civil violations with ERA in cases which also involve criminal prosecution by the Justice Department. As of December 1981, the Office of Enforcement had recovered \$44.0 million in refunds and \$5.7 million in civil penalties and fines, primarily from companies which were the subject of Justice's prosecutions. This compares to the \$32.9 million and \$4.7 million, respectively, discussed in our March 1981 report. ERA had only three active settlement negotiations during December 1981. Office of Special Counsel officials were unable to provide us with more current information on settlement negotiations with crude oil resellers. We were unable to determine the value of settlements for crude oil reseller violations by the Office of Special Counsel since Special Counsel's global settlements do not differentiate between the types of violations or the violation amounts. Instead, all violations are settled together.

#### ERA HAS SET UNREALISTIC OBJECTIVES

ERA's overall enforcement objectives, including the crude oil reseller program, for fiscal year 1982 are to

- --resolve as many cases as possible through negotiated settlements,
- --have all other cases ready for litigation or in litigation by September 30, 1982, and
- --refer all potential willful violations to the Department of Justice for prosecution.

In January 1982, the ERA Administrator told us that he believes ERA can meet these objectives. Crude oil reseller cases continue to receive high priority.

The administration is requesting \$13.5 million for the ERA enforcement program for fiscal year 1983. This would provide for only 263 full time equivalent positions during fiscal year 1983, a reduction of about two-thirds from the October 1981 workforce level of about 770. Regarding the "other than major refiner" category, which includes the crude reseller program, the proposed budget provides for only 37 full time equivalents for fiscal year 1983, compared to the 216 full time equivalents for fiscal year 1982. As of October 31, 1981, the crude reseller program had a work force of 77 personnel. If, as we believe, ERA does not substantially meet its objectives for fiscal year 1982, this drastically cut staff cannot reasonably be expected to effectively conclude the crude reseller program.

An ERA headquarter's official said that he believes this staff reduction can be achieved without harming the program because he expects an increase in the number of settlements with crude oil resellers for the following reasons:

- ++ERA has settled an important crude oil reseller case with one of the largest companies.
- --The crude oil reseller task force's report recommendations (see p. 10) will indicate to the oil industry that ERA is dedicated to resolving all violations.
- --ERA has recently issued two proposed remedial orders to crude oil resellers. The proposed remedial orders along with the orders in draft stage will encourage crude oil resellers to negotiate settlements.
- --DOE's dismantling plan requires open cases to be sent to the Department of Justice, and some crude oil resellers will prefer to settle with ERA rather than risk Justice Department action.

However, based on the conditions previously discussed--no litigative history, subpoena problems, loss of experienced employees, and poor settlement history--we believe ERA's fiscal year 1982 objectives are unrealistic. In this regard, ERA field auditors told us that there is little chance that ERA can issue proposed remedial orders on all audit cases by the end of fiscal year 1982, and that it is unlikely that many negotiated settlements will be consummated unless ERA resorts to "token" settlements. They defined "token" as being about "5 cents on a dollar." In April 1982, the ERA Administrator acknowledged that he would only be able to complete crude oil reseller audits by September 30, 1982, for cases where records are available, but he was uncertain as to when audits would be completed in cases where ERA has not gained access to the necessary company records.

#### ERA ACTIONS HAVE NOT ALLEVIATED CONFUSION AND DELAYS

The current Administrator has made some organizational and procedural changes which are supposed to streamline case processing. While it is too early to judge what impact these changes will have, several factors have already impeded desired program results. These include (1) the loss of experienced personnel, (2) the slowness in setting case priorities, and (3) the continued uncertainty about the future of the program.



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