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BY THE COMPTROLLER GENERAL

Report To The Chairman, Subcommittee On Oversight And Investigations Committee On Energy And Commerce House Of Representatives

OF THE UNITED STATES

Improvements Needed In The Department Of Energy's Petroleum Pricing And Allocation Compliance Program

Between August 1973 and January 1981 (the date the President lifted price controls on refined petroleum products) the Department of Energy's Economic Regulatory Administration and predecessor federal agencies established and enforced regulations controlling the allocation and pricing of crude oil and refined petroleum products. Through its compliance program, ERA has audited oil companies' compliance with these regulations and has identified alleged violations totaling billions of dollars. GAO found that the overly optimistic workload objectives for ERA's compliance program resulted in understated budgets. GAO questioned whether ERA has adequate assurance that the major refiners' alleged violations are equitably resolved because ERA

--has not maintained audit and compliance histories on each major oil refiner and

--had not assured that the computer program it uses in settling alleged violations effectively meets its needs.

GAO makes recommendations to increase audit coverage and to improve ERA's process for resolving alleged violations.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D C. 20548

B-208772 APRIL 18, 1984

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

Dear Mr. Chairman:

In response to your requests, this report discusses selected aspects of the Department of Energy's (DOE's) petroleum allocation and pricing compliance program established under the Emergency Petroleum Allocation Act of 1973. The report also discusses the proposed compliance budgets for the past 3 years, DOE's basis for resolving major refiners' alleged violations, and the status of our prior recommendation to audit all applicable major refiners' crude oil sales and purchase activities. The report makes recommendations to the Secretary of Energy to improve the compliance program. Also, on May 23, 1983, we testified before your Subcommittee on these and other matters.

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As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its date. At that time, we will send copies to the Secretary of Energy; the Director, Office of Management and Budget; and interested congressional committees. We will also make copies available to others upon request.

Sincerely yours,

for Milton J. Socolar
Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT

IMPROVEMENTS NEEDED IN THE DEPARTMENT OF ENERGY'S PETROLEUM PRICING AND ALLOCATION COMPLIANCE PROGRAM

D I G E S T

Between August 1973 and January 1981 (the date the President lifted the price controls on refined petroleum products) the Department of Energy's Economic Regulatory Administration (ERA) and predecessor federal agencies established and enforced regulations controlling the allocation and pricing of crude oil and refined petroleum products. Through its program, ERA has audited oil companies' compliance with these regulations and has identified alleged violations totaling billions of dollars. ERA has attempted to resolve these alleged violations through (1) negotiated settlements with the companies, (2) legal actions in courts of law, or (3) the administrative process through which ERA attempts to get companies to take specific actions to remedy alleged violations.

The Chairman, Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, requested GAO to assess

--the reasonableness of ERA's proposed fiscal year 1984 compliance program budget,

--ERA's basis for assuring that alleged violations are equitably resolved, and

--the extent of ERA's audit coverage of major oil refiners' crude oil sales and purchase activities.

OVERLY OPTIMISTIC OBJECTIVES RESULTED IN UNDERSTATED COMPLIANCE BUDGETS

Although ERA's fiscal year 1984 appropriation included $14.8 million for its compliance program (which GAO believed was a reasonable amount), ERA had originally proposed a fiscal year 1984 budget of only $7.1 million which was based on overly optimistic objectives--the third consecutive year this situation has existed.

ERA's proposed fiscal year 1984 budget estimate of $7.1 million, a $13.9 million decrease from the prior year, optimistically assumed that all audit and investigation work would be completed during fiscal year 1983. In fact, ERA only completed 125 of the 561 cases open at the beginning of fiscal year 1983. The remaining 436 cases, which involve major refiners, crude oil producers and resellers, and refined petroleum product resellers, were carried over into fiscal year 1984, causing the workload to be significantly more than provided for in the 1984 proposed budget.

In June 1983, ERA recognized this fact and increased the budget request to $15.1 million. The subsequent appropriation included $14.8 million for ERA's compliance program. (See pp. 6 to 8.)

ERA COULD BETTER ASSURE THAT ALLEGED VIOLATIONS BY MAJOR REFINERS ARE EQUITABLY RESOLVED

Alleged violations by all but 12 of the 35 major refiners have been resolved by ERA. Although tentative settlement agreements have been reached with 5 of the remaining 12 companies, the status of the five settlements has not changed since October 1982, and final settlements do not appear imminent. As of March 1984, ERA's Special Counsel told GAO that DOE was evaluating the effect of recent court decisions on these five tentative settlements. If these decisions increase ERA's chances of obtaining more favorable settlements, the Special Counsel believes that the cases should be renegotiated.

GAO reviewed ERA's documentation on 4 (selected by the Subcommittee's office) of the 12 major refiners, which had not yet negotiated final settlement agreements, to attempt to determine whether ERA had adequate assurance that all alleged violations were considered in developing the basis for negotiated settlements and litigations. GAO found that the documentation did not provide a complete history of the billions of dollars in alleged violations. For example, the documentation did not explain the

disposition of alleged violations by one refiner totaling $94.5 million.

The Special Counsel told GAO that the disposition process was too fast-paced to require complete documentation on all issues affecting refiners. GAO believes that in view of the billions of dollars in alleged violations, ERA should have taken sufficient time to at least minimally document the disposition of the settlement issues. Although GAO did not assess the reasonableness or equity of ERA's resolution of the alleged violations, GAO believes that, with such documentation, ERA could better assure that all alleged violations were considered in developing the basis for negotiated settlements and litigations. (See pp. 9 to 12.)

In its settlement and litigation activities, ERA uses a computer program, supplemented by manual calculations of several factors, to determine the potential overcharges resulting from a refiner's alleged violations. The computer program processes data at a summary level and neither the resultant computer runs nor the manual calculations identify the impact on individual overcharged customers. Consequently, although it is responsible for obtaining restitution for overcharged parties, ERA cannot assure that the final settlements with the major refiners include sufficient refunds for all overcharged customers. For example, the computer runs on one major refiner did not show whether, and to what extent, the refiner's total overcharges included a $7.8 million alleged overcharge of one customer.

In deciding to use this computer program, ERA did not make either a requirements study[1] or a

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[1]A requirements study is a fundamental step for a successful system development effort. The study would define the needs to be fulfilled and objectives to be met by the proposed system. Also, the study should result in a functional requirements document as described in the Federal Information Processing Standards Publication No. 38, Guidelines for Documentation of Computer Programs and Automated Data Systems.

similar analysis to assure that the computer program effectively addresses ERA's needs for adequately and equitably pursuing the settlement and litigation processes. In GAO's opinion, a requirements study is one method of providing such assurance. (See pp. 12 to 15.)

NEED TO EXPAND AUDIT COVERAGE OF MAJOR REFINERS

In its June 1, 1982, report, GAO recommended that ERA provide audit coverage of selected major refiners' crude oil sales and purchase activities where not precluded by a settlement agreement. In response to this recommendation, ERA said that it was conducting special investigations of a series of transactions between crude oil resellers and major refiners.

The purpose of special investigations is to uncover and pursue potential criminal violations. Civil audits differ from special investigations in that their purpose is to identify violations of the pricing and allocation regulations and to serve as the basis for repayment of overcharges to the harmed customers, which is one of ERA's primary responsibilities. Because special investigations are not designed to do this, GAO believes that ERA has not adequately responded to the June 1982 recommendation. Therefore, GAO continues to believe that ERA should perform civil audits of 11 of the 12 major refiners which have unresolved alleged violations. ERA has already audited the one company's crude oil sales and purchases. (See pp. 17 to 19.)

RECOMMENDATIONS TO THE SECRETARY OF ENERGY

GAO recognizes that all but 12 of the 35 major refiners have settled with ERA. However, because of the billions of dollars in alleged violations by these 12 companies and the need for an equitable resolution of all major refiner cases, GAO recommends that the Secretary of Energy have the ERA Administrator:

--Establish a case history for each of the 12 major refiners with unresolved issues. This history should include all relevant data, including audit reports, compliance documents, computer runs, and records of manual

calcul tions of potential violations. The resolution of all alleged violations should be clearly traceable in this history.

--Reevaluate the computer program and the attendant manual calculations used in settlements and litigation to determine whether a new program or modification to the existing program is needed to enable ERA to effectively meet its responsibility for obtaining restitution for overcharged parties. One method of making this determination is through a requirements study. (See p. 16.)

To properly conclude the compliance program and to assure that ERA provides the **audit coverage necessary to meet its responsibility for identifying violations of the petroleum pricing regulations**, GAO further recommends that the Secretary of Energy have the ERA Administrator provide for audit coverage of the 11 major refiners whose crude oil sales and purchases have not been subjected to civil audits and which have not entered into settlements. In determining its future resource requirements, ERA should factor in the resources needed to perform these audits. (See p. 19.)

AGENCY COMMENTS

GAO did not obtain agency comments on this report.

Tear Sheet

Contents

ABBREVIATIONS

DOE	Department of Energy
ERA	Economic Regulatory Administration
FTE	full-time equivalent
GAO	General Accounting Office
NOPV	notice of probable violation
PRO	proposed remedial order

CHAPTER 1

INTRODUCTION

The physical flow of crude oil through the refinery process to ultimate consumption is not complicated. A domestic producer or crude oil importer sells the oil to a refiner, possibly through a crude oil reseller. The refiner sells the refined products to a retailer, again possibly through a reseller. The retailer sells the refined products to the consumer.

The government intervened in the market price structure for crude oil and refined petroleum products in 1970 to stem the growth of inflation in the economy in general. In 1973, it became necessary for the government to take more specific action to regulate the price of crude oil and refined products and to ensure the fair allocation of petroleum supplies. In late 1973 and early 1974, the Organization of Petroleum Exporting Countries put an embargo on crude oil exports to the United States and then dramatically increased the price of its crude oil exports. Consequently, the Congress attempted to minimize adverse repercussions from these actions by passing the Emergency Petroleum Allocation Act of 1973 (15 U.S.C. 751 et seq.), which was primarily intended to

--prevent price gouging by domestic crude oil producers which were able to produce oil at a fraction of the cost of imported oil and

--assure fair allocation of crude oil supplies and petroleum products to all levels of the marketing chain.

The pricing regulations applicable to the sale of covered petroleum products were originally promulgated on August 19, 1973 (38 F.R. 22536, Aug. 22, 1973) by the Cost of Living Council under the Economic Stabilization Act of 1970, as amended (12 U.S.C. 1904, note). In December 1973, the Federal Energy Office was established and was delegated authority to enforce both the pricing regulations and the allocation regulations implemented under the Emergency Petroleum Allocation Act of 1973. The Federal Energy Office later transferred the pricing regulations to the Federal Energy Administration[1] along with the authority vestedin the President by the Emergency Petroleum Allocation Act of 1973. Then, in October 1977, the Department of Energy Organization Act (42 U.S.C. 7151) transferred all functions vested by law in the Federal Energy Administration to the Secretary of Energy. In the same month, the authority previously granted to the Federal Energy Administration by Executive Order No. 11790 was redelegated to the Department of Energy (DOE).[2]

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[1]Executive Order No. 11790 (39 F.R. 23185, June 27, 1974).

[2]Executive Order No. 12009.

The Secretary of Energy redelegated to the Administrator, Economic Regulatory Administration (ERA), the authority and responsibility to establish and enforce compliance with the regulations. ERA and the above-mentioned agencies had responsibility for enforcing compliance with the regulations from August 19, 1973 (the date price controls were established) until January 28, 1981 (the date the President issued Executive Order 12287 lifting all price controls on refined petroleum products). ERA still has the authority and responsibility to enforce the regulations for violations that occurred during the regulatory period.

ERA carries out this responsibility through its compliance program. Specifically, ERA is responsible for (1) identifying violations of petroleum pricing and allocation regulations, (2) recovering overcharges, and (3) obtaining restitution for injured parties. Crude oil producers and resellers, petroleum refiners, and refined petroleum product resellers and retailers were subject to the pricing and allocation regulations. ERA considered them to be in violation of the regulations if they (1) obtained a price higher than the regulations permitted or (2) imposed terms or conditions not customarily imposed. Such violations included, but were not limited to: making use of inducements, kickbacks, premiums, discounts, falsification of records, substitution of inferior commodities, or failure to provide the same service and equipment previously provided.

When ERA, through its audits, alleges civil violations of the allocation and/or pricing regulations, it may negotiate a settlement with the oil company. In seeking resolution of the alleged violation, ERA may initiate administrative action separate from, or concurrent with, the settlement negotiations. At any time in this process, ERA may also initiate legal action in a court of law to resolve the alleged violations. If a settlement is achieved, a consent order is written to specify the actions ERA and the company agree will settle the alleged violations. When a settlement is not achieved, ERA issues a proposed remedial order to the company which specifies the alleged violations and recommends remedial action. If the company does not agree with the proposed remedial order, DOE's Office of Hearings and Appeals administratively adjudicates the case. If the Office of Hearings and Appeals concludes that a violation exists, it issues a final remedial order to the company, which can appeal the order to the Federal Energy Regulatory Commission (42 U.S.C. 7193) and to the district courts of the United States (42 U.S.C. 7192 (b)). The company can appeal further to the Temporary Emergency Court of Appeals.

During the period of allocation and price controls, ERA had over 2,000 employees and 50 field offices. Since decontrol, ERA has been phasing down its operations. The Congress has been concerned that ERA's proposed rate of phase down has been too fast and, as a result, set ERA's minimum employee level at 450

full-time permanent employees from October 1982 through July 1983. For the remainder of fiscal year 1983, in line with the gradual phase down of ERA's operations, the Congress reduced ERA's minimum employee level to 380 full-time permanent employees. The Congress has further reduced this level to 305 full-time equivalent employees (work equated to 1 staff year which is performed by one or more employees during a fiscal year) for fiscal year 1984. As of December 10, 1983, ERA's staff was down to 369, with six field offices. The compliance program's funding has decreased from about $42.5 million in fiscal year 1981 to $14.8 million in fiscal year 1984.

PRIOR REPORTS

We have issued several reports on ERA's enforcement of the regulations promulgated under the Emergency Petroleum Allocation Act of 1973. In our May 29, 1979, report,[3] we said that DOE needed to strengthen its enforcement procedures and practices by ensuring adequate audit coverage of crude oil resellers. In our March 31, 1981, report,[4] we said that DOE made considerable improvements in the audit coverage of major refiners and crude oil resellers but noted that, as of October 1980, ERA had charged major refiners with regulatory violations of about $10.8 billion, of which $9.4 billion were still unresolved. Also, we expressed our concern about the Office of Management and Budget's proposed reduction from $46 million to $12 million in ERA's compliance program budget for fiscal year 1982 and the impact it might have on ERA's ability to enforce the compliance program. (See ch. 2.)

In our June 1, 1982, report,[5] we said that ERA had not audited 30 of the 35 major refiners' crude oil sales and purchase activities. We recommended that ERA audit major refiners' crude oil sales and purchase activities with crude oil resellers, where not precluded by the terms of existing settlements. ERA has not adequately responded to this recommendation. In chapter 4, we discuss this subject in more detail and present our further views on the issue.

In our June 1982 report, we also questioned ERA's ability to meet its enforcement program objectives for fiscal year 1982 because of slow issuance of proposed remedial orders, subpoena problems, loss of experienced employees, and a poor settlement

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[3]Improvements Needed in the Enforcement of Crude Oil Reseller Price Controls (EMD-79-57, May 29, 1979).

[4]Department of Energy Needs To Resolve Billions in Alleged Oil Pricing Violations (EMD-81-45, Mar. 31, 1981).

[5]Department of Energy Has Made Slow Progress Resolving Alleged Crude Oil Reseller Pricing Violations (GAO/EMD-82-46, June 1, 1982).

history. In addition, we pointed out that oil companies with outstanding alleged violations may perceive ERA's budget understatements as a lack of commitment to effectively conclude the program and may be encouraged not to cooperate with ERA in settling alleged violations. As a result, we questioned ERA's ability to effectively operate the crude oil reseller program with a fiscal year 1983 budget of $13.5 million as proposed by the administration.

OBJECTIVES, SCOPE, AND METHODOLOGY

At the request of the Chairman, Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, and in subsequent discussions with his office, we agreed to assess

--the reasonableness of ERA's proposed fiscal year 1984 compliance budget,

--ERA's basis for assuring that alleged violations are equitably resolved, and

--the extent of ERA's audit coverage of major refiners' crude oil sales and purchase activities.

We conducted our audit work at DOE headquarters in Washington, D.C., which has primary responsibility for developing DOE's budget, negotiating settlements with major refiners, and approving global consent orders which settle all of the major refiner's alleged violations except those specifically excluded from the terms of the order. We examined applicable legislation, policies, procedures, regulations, correspondence, audit reports, compliance documents, statistical reports, computer print outs, settlement agreements, and ERA's budget material. We interviewed DOE headquarters officials in the Office of the Controller and ERA.

We evaluated the reasonableness of ERA's fiscal year 1984 compliance budget as originally proposed to the Congress. In making this evaluation, we obtained and analyzed ERA's staffing and caseload statistics for fiscal years 1981-84. We looked at the historical composition of ERA's staff and the types of cases in which they were involved. We analyzed ERA's fiscal year 1983 compliance caseload and case completions and compared these with ERA's estimates for the start of fiscal year 1984. This analysis formed the basis for our opinion about the reasonableness of ERA's originally proposed fiscal year 1984 budget. However, we did not do an in-depth analysis to determine ERA's fiscal year 1984 compliance resource requirements.

We scheduled the alleged violations from the audit reports and compliance documents (notices of probable violation, proposed remedial orders, and remedial orders) provided by ERA for 4 of the 12 major refiners which had not yet negotiated final settlement

agreements. (The Subcommittee selected the four major refiners to be included in our review.) We also interviewed ERA officials regarding the accuracy and completeness of the schedules. However, we did not assess the reasonableness or equity of ERA's negotiated settlements with the major refiners.

We conducted a case study of the computer runs for one major refiner to determine how well ERA's computer program is designed to assist ERA in negotiating settlements. (The Subcommittee requested that we only review one major refiner and identified which refiner it should be.) To help us in this study, we obtained the assistance of a contractor who had previously worked with ERA as both an auditor and a computer specialist. We also obtained information on the negotiation process through interviews and written correspondence. However, we did not make a detailed analysis of the capability and effectiveness of the computer program. Rather, our schedule of the four major refiners' alleged violations and our analysis of the computer runs for one major refiner formed the basis for our assessment of ERA's basis for assuring that alleged violations by major refiners are equitably resolved.

Through discussions with ERA officials and analysis of their response to the recommendation in our June 1, 1982, report, we determined the extent of ERA's audit coverage of major refiners' crude oil transactions. We also evaluated the provisions of selected global consent orders with major refiners to determine their impact on ERA's authority to audit major refiners' sales and purchase activities with crude oil resellers.

At the Subcommittee's request, we did not obtain agency comments on this report.

Except as noted above, we made our review in accordance with generally accepted government auditing standards.

CHAPTER 2

OVERLY OPTIMISTIC OBJECTIVES FOR THE COMPLIANCE PROGRAM RESULTED IN UNDERSTATED BUDGETS

The Subcommittee has had a continuing interest in maintaining an adequate budget for ERA's compliance program and requested that we assess the reasonableness of ERA's proposed fiscal year 1984 compliance budget. Although ERA's fiscal year 1984 appropriation included $14.8 million for its compliance program (which we believed was a reasonable amount), ERA had originally proposed a fiscal year 1984 budget of only $7.1 million, which marked the third straight year ERA's originally proposed compliance budget was underestimated when compared to the resources needed to adequately meet the projected workload.

In March 1983,[1] we questioned the reasonableness of ERA's fiscal year 1984 compliance budget, as submitted to the Congress in January 1983. We pointed out that the proposed fiscal year 1984 budget was based on overly optimistic workload projections. ERA had requested $7.1 million and 120 full-time equivalent (FTE) positions for fiscal year 1984. The $7.1 million was a $12.7 million (64 percent) decrease from the fiscal year 1983 appropriation and was based on the projected completion of all audit and investigation work during fiscal year 1983 and settlements with all but 2 or 3 of the 35 major refiners. As discussed in the following paragraph, this was an overly optimistic estimate.

At the start of fiscal year 1983, ERA had 499 civil cases[2] and 62 special investigations. Also, ERA was in the process of settling with 12 of the major refiners. During the first quarter of fiscal year 1983, ERA completed 104 civil cases and 2 special investigations. To meet the projections in the fiscal year 1984 budget, ERA would have had to significantly increase its case completions over the last three quarters of fiscal year 1983. Specifically, ERA would have had to complete 395 civil cases, 60 special investigations, and negotiate settlements with 9 major refiners during the last three quarters of fiscal year 1983. Therefore, in March 1983 we questioned whether ERA would be able to accomplish these goals during the remainder of fiscal year 1983 and, consequently, whether the $7.1 million requested for fiscal

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[1] GAO Staff Views on the President's Fiscal Year 1984 Budget Proposals (GAO/OPP-83-1, Mar. 4, 1983).

[2] These cases involve major refiners, crude oil producers and resellers, and petroleum product resellers. Some companies, particularly major refiners, can be involved in more than one case.

year 1984 was adequate to effectively complete the compliance program. Actually, ERA completed 112 civil cases, 13 special investigations, and did not negotiate any settlements with major refiners during the last three quarters of fiscal year 1983.

In addition to its overly optimistic workload projections, ERA's proposed fiscal year 1984 budget was based on the assumption that the congressionally imposed minimum of 450 ERA employees would be repealed. Section 303 of Public Law 97-257 (September 10, 1982) required ERA to maintain no less than 450 full-time permanent federal employees. In developing its fiscal year 1984 budget, ERA assumed this minimum would be lifted, enabling it to reduce its compliance workforce to the 120 FTE level. However, under Public Law 98-63 (July 30, 1983), the Congress changed ERA's minimum employee level to 380 full-time permanent employees for the remainder of fiscal year 1983 and to 305 FTEs for fiscal year 1984.

On April 5, 1983, ERA revised its workload projections for fiscal year 1984. The revised projections included 90 active audit cases as of October 1, 1983, compared to the earlier projection in the proposed fiscal year 1984 budget justification that all such audits would be completed by that date. ERA maintained that the requested $7.1 million and 120 FTEs would be sufficient to handle this revised compliance workload, because these requested amounts would allow ERA to have 30 to 40 auditors on board at the beginning of fiscal year 1984 who would then be gradually phased out. However, ERA had not conducted any studies or made any analyses to support its revised projections.

On May 23, 1983, the ERA Administrator testified before the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, that the proposed fiscal year 1984 budget was being reevaluated based on an analysis of the resources needed to meet the revised fiscal year 1984 workload projections. On June 20, 1983, the Administrator submitted ERA's revised analysis of its fiscal year 1984 resource requirements, which included 235 FTEs and $15.1 million for ERA's compliance program. The subsequent appropriation included $14.8 million for ERA's compliance program, which was based on 231 FTEs.

The proposed fiscal years 1982 and 1983 budgets for ERA's compliance program were also underestimated when compared to the resources needed to adequately meet the projected workload. The Subcommittee was concerned about the adequacy of these proposed budgets and requested us to analyze them. In our March 31, 1981, report, we said that the Office of Management and Budget's proposed reduction in ERA's fiscal year 1982 compliance budget from $46 million to $12 million would seriously impair ERA's ability to enforce the compliance program. We questioned whether this cut was based on a workload analysis that adequately considered the orderly resolution of the outstanding violations and litigation. In our June 1, 1982, report, we questioned whether ERA's proposed

fiscal year 1983 budget of $13.5 million would provide adequate resources to effectively conclude the crude oil reseller compliance program.

For both fiscal years 1982 and 1983, the Congress, after considering the testimony and other data gathered on these budgets, including our reports, appropriated amounts significantly greater than those requested in ERA's proposed budgets. According to DOE's congressional budget requests for fiscal years 1984 and 1985, the amounts appropriated for economic regulation included $33.6 million for the 1982 compliance program and $19.8 million for the 1983 compliance program.

CHAPTER 3

ERA COULD BETTER ASSURE THAT ALLEGED VIOLATIONS BY MAJOR REFINERS ARE EQUITABLY RESOLVED

ERA has three methods of resolving alleged allocation and/or pricing violations with major refiners. It can (1) negotiate a global settlement which settles all of the major refiner's alleged violations except those which are specifically excluded from the terms of the settlement, (2) institute legal action in a court of law, or (3) initiate the administrative process. Although we did not assess the reasonableness or equity of ERA's resolution of the major refiners' alleged violations, we question whether ERA has adequate assurance that these major refiner cases are equitably resolved because ERA

- --has not maintained audit and compliance case histories on each major refiner which would document resolution of the alleged violations and
- --has not made a requirements study or any similar analysis to assure that the computer program and the attendant manual calculations used in the settlements and litigation effectively meet ERA's needs.

NEED TO ASSURE THAT ALL RELEVANT AUDIT AND COMPLIANCE DOCUMENTS HAVE BEEN ADEQUATELY CONSIDERED

Because it does not have an audit and compliance case history on each of the major refiners, ERA does not have the documentation available which could be used to trace the disposition of each alleged violation. Without such documentation, ERA cannot demonstrate whether the disposition was fair and equitable.

ERA generally identifies major refiners' alleged violations during its audits of the refiners. After completing an audit, ERA has three options to resolve the audit findings. First, ERA can initiate the administrative process, which prior to October 1981 generally included issuing the refiner a notice of probable violation (NOPV) which specified the alleged violations. If after the refiner had an opportunity to respond to the NOPV, ERA still considered the refiner to be in violation, it issued the refiner a proposed remedial order (PRO), which specified the alleged violations and recommended remedial actions. The refiner may then file with DOE's Office of Hearings and Appeals a statement of objections which describes the refiner's position regarding ERA's allegations. If the Office of Hearings and Appeals concludes that a violation exists, it issues a final remedial order to the company.

Beginning about October 1981, ERA began bypassing the NOPV stage and going directly to the issuance of PROs.

A second option is to institute legal action in a court of law. This option can be selected by either party at any time. For example, if a case is with the Office of Hearings and Appeals in the administrative process, the major refiner can take the issue to the district court for resolution.

The third option is to negotiate settlements. Settlement negotiations can begin at any time and can even be conducted concurrently with the administrative process. In an attempt to avoid the cost and time involved in litigating cases in court and in the Office of Hearings and Appeals, ERA has chosen to negotiate settlements as the principal means of resolving alleged allocation and/or pricing violations with the major refiners. These settlements result in consent orders which specify the terms of the settlements.

As of March 1984, the status of ERA's settlement efforts with 34 of the 35 major refiners (no violations for one refiner) was as follows:

--Issued 22 global consent orders.

--Negotiated five tentative global consent orders.

--In process of negotiating global settlements with five companies.

--Won a court case in March 1983 against one company which settled most of the violations. The remaining violations have not been settled.

--Broke off settlement negotiations with one company and is now pursuing the administrative process.

Except for the March 1983 court decision, the above status of the other 11 major refiner settlements was the same as in October 1982. In March 1984, the ERA Special Counsel told us that as a result of recent court decisions, DOE was evaluating the effect of these decisions on the five tentative global settlements. He was uncertain as to when the 12 settlements would be finalized.

To determine if ERA had appropriately disposed of all alleged violations, the Subcommittee requested us to trace the alleged violations from the audit reports through the NOPVs to the PROs for the 12 major refiners which, as of October 1982, had not yet signed global consent orders and which had alleged violations. On October 26, 1982, we asked ERA for copies of all audit reports, NOPVs, PROs, and any other compliance documents applicable to these refiners.

Because of (1) the voluminous nature of these documents and (2) the fact that ERA did not maintain a case history on each major refiner, we encountered delays in obtaining the documents from ERA. Therefore, on December 14, 1982, in agreement with the Subcommittee office, we limited our request for documents to three major refiners which had negotiated but not finalized global consent orders. Subsequently, on January 14, 1983, we requested the same information on a fourth major refiner which was involved in ongoing negotiations. We again experienced delay in obtaining these documents. Subsequently, on February 4, 1983, ERA told us that we had been provided copies of all compliance documents pertaining to the four companies. However, in reviewing the documents furnished by ERA, we found references to 12 other documents, including 6 PROs, which had not been provided to us. After we identified the 12 documents, ERA provided us with copies.

In our opinion, ERA did not know whether they had given us all applicable documents because ERA does not maintain a centralized control over all compliance documents applicable to each refiner.

During our analysis of the ERA-furnished documents, we found that the documents did not provide a complete history of the disposition of all alleged violations. The following table shows the total dollar amount of the alleged violations contained in ERA's audit reports, NOPVs, and PROs pertaining to the four companies.

Document	Amount of alleged violation
	(in billions)
Audit reports	$3.2
NOPVs	2.2
PROs	5.2

In our analysis, we were not able to trace all of the $3.2 billion of alleged violations in the audit reports through the NOPVs and to the PROs. Also, the documents did not provide reasons why the $3.2 billion in alleged violations in the audit reports decreased to $2.2 billion in the NOPVs and increased to $5.2 billion in the PROs. We encountered examples of this type of fluctuation in our analysis of the documents pertaining to all four companies. For example, the audit reports on one company contained $825.5 million in alleged violations. We were able to trace only $5.9 million of these violations to both NOPVs and PROs. Another $725.1 million in alleged violations could only be traced to NOPVs but not to a PRO. We could not trace the remaining $94.5 million to either a NOPV or a PRO. In addition, we

could not trace $40.8 million in alleged violations in a PRO to either a NOPV or an audit report. Because there was no audit trail, we could not determine the disposition of millions of dollars in alleged violations.

In discussing this absence of an audit trail with ERA officials, they said that each alleged violation is evaluated on its own merits and a judgmental decision is reached on whether it could be sustained in the courts. The ERA Special Counsel told us that although ERA decided for each major refiner which issues were worth pursuing, it did not always document those decisions. He said that this process was too fast-paced to require complete documentation of all issues affecting refiners and that there is no central file for each major refiner which would contain a history of the alleged violations. He also said that it would be too time consuming to explain what happened to each alleged violation because this would involve reconstructing the work done on each case.

We believe that, in view of the billions of dollars involved in these alleged violations, ERA should have taken the time to at least minimally document the disposition of these issues. In addition, we believe that this documentation could serve as an audit and compliance case history which ERA could use to respond to questions and concerns raised about the basis for certain settlement agreements.

We believe that a case history containing all relevant audit and compliance information should have been maintained for each major refiner as a management control technique. Such information should have included audit reports, compliance documents, computer runs, and records of manual calculations of potential violations. By using this history, ERA could better assure that (1) all alleged violations were considered in developing the basis for negotiations and litigation and (2) an audit trail exists which could be used to determine the disposition of all alleged violations. We recognize that it would not be feasible for ERA to reconstruct these histories for those cases which have been settled or otherwise resolved. However, we believe it should be done for the remaining 12 major refiners.

ABSENCE OF REQUIREMENTS STUDY FOR COMPUTER PROGRAM

In 1976, ERA began developing a computer program for use in both litigating and negotiating settlements on major refiner cases. Because this program was not designed to perform all of the calculations required to determine whether a refiner overcharged customers, ERA manually makes several of the required calculations. In deciding to use this computer program, ERA did

not make either a requirements study[1] or a similar analysis to assure that this computer program effectively addresses ERA's needs for adequately and equitably pursuing the settlement and litigation processes. For example, because the program processes data at a summary level, its output does not identify the impact on individual overcharged customers. Also, the manual calculations do not identify these impacts. Therefore, ERA cannot assure that the final settlements with the major refiners include sufficient refunds for all overcharged customers.

ERA uses the computer program to determine the potential monetary overcharge impact from certain DOE regulatory issues. Using this program, which the ERA Special Counsel believes closely tracks the regulatory refiner pricing formula, ERA inputs data to the computer. The resultant computer print outs contain the potential impact of the alleged violations by identifying the dollar amount of the overcharges resulting from the alleged violations.

ERA's computer program was not designed to accommodate several factors which impact on whether a refiner overcharged customers. As a result, several of the steps in the refiner pricing formula are done manually. These steps are the retail equalization and gasoline tilt rules; price maintenance, bank optimization, and bank usage; cost reallocation and negative banks; and treatment of exempt product banks. These factors are important aspects of ERA's regulations because they impact on whether refiners' selling prices were within limits imposed by ERA regulations. For example, the retail equalization tilt rule permitted a refiner to allocate an additional 3 cents a gallon (increased to 8.6 cents in April 1980 and subsequently increased to 9.3 cents in June 1980) of its increased product costs to the prices charged for gasoline sold through refiner-operated stations. This additional increase was allowed in order to compensate for the higher cost of gasoline sold at independent dealer-operated stations, provided that a corresponding reduction was made in the amount of increased product costs allocated to the price of gasoline sold through independent dealer-operated stations. In addition, the price maintenance regulations were designed to alleviate the

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[1]A requirements study is a fundamental step for a successful system development effort. The study would define the needs to be fulfilled and objectives to be met by the proposed system. This is critical to the developmental effort because it directly impacts subsequent activities, such as conceptual system design; feasibility study; cost-benefit analysis; systems analysis; design, programming, and testing; and procedures preparation. This study should result in a functional requirments document as described in the Federal Information Processing Standards Publication No. 38, Guidelines for Documentation of Computer Programs and Automated Data Systems.

possible drastic fluctuations in petroleum prices effected by monthly differences in cost increases available for passthrough and reaction by refiners to abrupt changes in market conditions. The price maintenance regulations further adjusted the amount of banked costs (unrecouped costs for recovery in subsequent months) a refiner could recover during a particular month, thus reducing the monthly price fluctuation.

ERA's computer program processes data at a summary level and neither the resultant computer runs nor the manual calculations identify the impact on individual overcharged customers. For example, ERA issued a PRO to a major refiner alleging that the refiner had overcharged one of its customers by $7.8 million. In processing this alleged violation, however, the computer did not retain the identity of the alleged $7.8 million violation. Rather, the computer assimilated this information, along with the other data and assumptions ERA inputted, and the resultant computer runs only showed in total whether the refiner had overcharged customers. The computer runs did not show the impact on individual customers. Furthermore, our analysis of the computer runs showed that only a small part of the $7.8 million alleged violation was included in the total refiner overcharge. (Because this major refiner case is still open, the $7.8 million alleged violation is unresolved.) Consequently, although one of its primary responsibilities is to obtain restitution for overcharged parties, ERA cannot assure that the final settlements with the major refiners include sufficient refunds for all overcharged customers.

ERA did not make a requirements study or any similar analysis to determine whether the program would effectively meet ERA's litigation and settlement data analysis needs. The ERA Special Counsel said that such studies were not necessary because the needs and objectives were obvious to anyone familiar with the refiner pricing regulations. Although the needs and objectives, in general, may be obvious to anyone familiar with the regulations, we believe that ERA needs to assure that its specific needs and objectives will be met. We believe that a requirements study or a similar analysis would provide such assurance. Such an analysis would define and document the needs to be fulfilled and objectives to be met by the proposed system.

ERA's Special Counsel recognizes that the computer program has to be supplemented by manual calculations and does not retain the identity of individual alleged violations. However, he believes that it would have been extremely difficult to construct a program that could accommodate all the necessary calculations and individually track the impact on specific customers. He told us that, with the multitude of variables possible in calculating refiners' maximum allowable selling prices, it would have been difficult and time-consuming to factor all such variables into the computer program. Also, the central processing unit time required by the computer to address all these variables would have been

costly. However, ERA did not make a study to determine just how difficult or costly it would have been. When a multitude of variables and complex calculations are involved, computers are generally more efficient and accurate in handling such tasks than manual calculations. Therefore, in view of the billions of dollars involved in the unsettled cases, and our concerns about the present computer program/manual calculation system, we believe that ERA should reevaluate its present system to determine what changes are needed to fairly and effectively address its data analysis needs.

CONCLUSIONS

ERA has negotiated global settlements with 22 of the major refiners and will negotiate settlements, litigate, or administratively resolve the open issues with the remaining 12 major refiners. The cases for these major refiners involve billions of dollars in alleged violations. Although we did not assess the reasonableness or equity of ERA's resolution of the major refiners alleged violations, we question whether ERA has adequate assurance that these cases are being equitably resolved because of the following two factors.

First, ERA does not have a case history for each major refiner containing all relevant audit, compliance, and other documentation which would clearly show the disposition of all alleged violations. We believe that proper management procedures and controls dictate that such documentation be developed and maintained for the 12 major refiner cases which are still open. Such documentation would strengthen ERA's basis for ensuring that the disposition of each alleged violation was equitable.

Second, in deciding on the type of computer program to be used to assist in litigating and negotiating settlements on major refiner cases, ERA did not conduct the appropriate requirements study or similar analysis to determine whether the program would effectively address ERA's data analysis needs.

Although we recognize that all but 12 of the 35 major refiners have settled with ERA, we believe that the billions of dollars in alleged violations by these 12 companies and the need for an equitable resolution of all major refiner cases calls for ERA to address the above two factors as they pertain to the 12 companies. Also, the resolution of the cases involving these 12 companies does not appear to be imminent. As of March 1984, the ERA Special Counsel told us that DOE was evaluating the effect of recent court decisions on these cases. He was uncertain as to when the alleged violations for the 12 companies might be resolved. If these decisions increase ERA's chances of obtaining more favorable settlements, he believes that the settlements should be renegotiated. Therefore, we believe it would be worthwhile for ERA to take the time needed to address the above two

items and thereby better assure that all major refiner cases are equitably resolved.

RECOMMENDATIONS TO THE SECRETARY OF ENERGY

We recognize that all but 12 of the 35 major refiners have settled with ERA. However, because of the billions of dollars in alleged violations by these 12 companies and the need for an equitable resolution of all major refiner cases, we recommend that the Secretary of Energy have the ERA Administrator:

--Establish a case history for each of the 12 major refiners with unresolved issues. This history should include all relevant data, including audit reports, compliance documents, computer runs, and records of manual calculations of potential violations. The resolution of all alleged violations should be clearly traceable in this history.

--Reevaluate the computer program and the attendant manual calculations used in settlements and litigation to determine whether a new program or modification to the existing program is needed to enable ERA to effectively meet its responsibility for obtaining restitution for overcharged parties. One method of making this determination is through a requirements study.

CHAPTER 4

NEED TO EXPAND AUDIT COVERAGE OF MAJOR REFINERS' SALES AND PURCHASES OF CRUDE OIL

Although ERA has audited several aspects of major refiners' operations, ERA has not audited certain major refiners' crude oil sales and purchases involving crude oil resellers. In our June 1, 1982, report, we recommended that ERA provide audit coverage of selected major refiners' crude oil sales and purchase activities where not precluded by a global settlement. To date, ERA has not adequately responded to this recommendation. We continue to believe that, in the interest of treating all companies equitably, all potential and/or alleged violations should be pursued until they are properly resolved.

CONTINUING CONCERN ABOUT ERA'S AUDIT COVERAGE OF MAJOR REFINERS

In our June 1, 1982, report, we recommended that ERA audit those major refiners' crude oil sales and purchase transactions with crude oil resellers where not precluded by global settlements. The basis for our recommendation was that ERA had not conducted civil audits of the crude oil sales and purchase transactions for 30 of the 35 major refiners. (As of Jan. 12, 1984, only 11 of these 30 major refiners had not entered global settlements with DOE and thus could be subject to a civil audit. One of the 12 major refiners which have not yet entered into global consent orders was 1 of the 5 major refiners whose crude oil sales and purchases ERA audited.)

Office of Special Counsel field officials told us that ERA did not audit these 30 companies for possible crude oil reseller violations because ERA had determined that these companies had not established their own crude oil reseller enties as profit-making ventures. According to ERA, these purchases and sales were merely for the purpose of acquiring proper qualities and quantities of crude oil for refining purposes. The Office of Special Counsel made this decision even though it was aware of the findings of the former Office of Enforcement's July 1980 study which indicated that some major refiners were obtaining financial benefits through the entitlements program[1] by selling significant volumes of crude oil certified for lower prices to crude oil resellers and purchasing back crude oil certified in many instances for higher prices.

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[1]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.

On August 25, 1982, the Assistant Secretary of Energy responded to our recommendation in the June 1982 report. He agreed that additional inquiry is needed to determine the extent of major refiner involvement, if any, in unlawful crude reseller activities. He further said that the Office of General Counsel and the Office of Special Counsel were reviewing a series of transactions between crude resellers and major refiners to determine whether these transactions were undertaken to evade the regulatory obligations of the participants.

On November 10, 1982, we responded to the Assistant Secretary's letter by stating that his comments were not fully responsive to our recommendation. We said that DOE's review is for special investigations which involve potential criminal violations. We also said that although special investigations are the proper vehicle for uncovering and pursuing potential criminal violations, such investigations are not designed to result in the repayment of overcharges to customers. Rather, the purpose of these investigations is to determine if ERA has adequate justification to refer a case to the Department of Justice for possible criminal prosecution. Therefore, unless ERA conducts civil audits of major refiners' purchases and sales activities, it will not fullfill its responsibility for disclosing any overcharges resulting from such activities and obtain restitution for overcharged customers. DOE did not respond to our November 10 letter. In subsequent discussions with ERA's Special Counsel in May and August 1983, we determined that ERA's official views on this subject were the same as those expressed in the Assistant Secretary of Energy's August 25, 1982, letter.

Global consent orders negotiated by ERA can prohibit ERA from conducting future audits of the major refiners crude oil sales and purchase activities. ERA has settled most of the major refiners' alleged violations of the petroleum pricing and allocation regulations by means of global consent orders. Under terms of these orders, the refiners agree to pay specified dollar amounts, and, in return, ERA releases the refiners from further civil actions in all areas of alleged violations. The only exceptions are (1) if an area is specifically precluded from the terms of the order or (2) ERA can show that a refiner knowingly concealed information.

Of the 30 major refiners whose crude oil sales and purchases have not been subject to civil audits, DOE can perform civil audits on only 11. Of the remaining 19 companies, 1 refiner is a cooperative and any alleged violations would not have resulted in overcharges because the customers are the owners. Therefore, ERA never alleged any violations against this cooperative. The other 18 companies have settled with DOE by means of global consent orders, which prohibit DOE from doing further audit work unless a specific area has been excluded from one or more of the global consent orders. Based on our review of these 18 global consent orders and our discussion with an ERA Deputy Solicitor, these consent orders generally covered the refiners' crude oil sales and

purchase transactions. Therefore, ERA is generally prohibited from doing further audit work on these transactions.

CONCLUSION

Unless ERA conducts civil audits of major refiners' crude oil sales and purchase activities, any overcharges resulting from such activities may not be disclosed and refunds may not be made where appropriate. In our June 1, 1982, report, we recommended that ERA provide audit coverage of selected major refiners' crude oil sales and purchase activities where not precluded by a global consent order. ERA has not implemented this recommendation to conduct civil audits, but is making a series of special investigations. We recognize the value of special investigations. However, they involve potential criminal violations and are not designed to result in the repayment of overcharges to customers. Therefore, we continue to believe that ERA should perform civil audits of major refiners' crude oil sales and purchase activities.

RECOMMENDATION TO THE SECRETARY OF ENERGY

To properly conclude the compliance program and to assure that ERA provides the **audit coverage necessary to meet its responsibility for identifying violations of the petroleum pricing regulations,** we recommend that the Secretary of Energy have the ERA Administrator provide for audit coverage of the 11 major refiners whose crude oil sales and purchases have not been subjected to civil audits and which have not entered into settlements. In determining its future resource requirements, ERA should factor in the resources needed to perform these audits.

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