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REPORT BY THE U.S.

General Accounting Office

Department Of Energy Needs To Develop Better Guidance For Settling Oil Overcharge Cases With Long-Term Payment Provisions

Between August 1973 and January 1981, the Department of Energy and predecessor federal agencies established and enforced regulations controlling the allocation and pricing of crude oil and refined petroleum products. Energy is currently settling, on behalf of the overcharged customers, the alleged violations that occurred during the regulation period. One means Energy uses is to negotiate long-term (payment periods exceeding 2 years) settlements with oil companies. As of April 1984, Energy had negotiated 59 long-term settlement agreements totaling $104.8 million.

Energy had no written procedures or guidelines for its negotiators to use in long-term settlement agreements with the oil companies and to ensure that the terms of such agreements were justified. Furthermore, Energy did not adequately document its justification for entering into these settlements. Therefore, GAO could not determine whether the long-term settlement agreements were equitable and whether the companies would be financially able to meet them.

Additionally, for 20 0f the 59 cases, Energy did not specify the amount of interest to be paid on the outstanding balances. By not separating interest charges from the settlement amounts, Energy overstated the principal amounts it accepted as resolution of the alleged pricing violations.

UNITED STATES GENERAL ACCOUNTING OFFICE

127938

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

B-214953

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 request, this report discusses the adequacy of the Department of Energy's (DOE) basis for negotiating agreements with oil companies to settle their alleged violations of the petroleum pricing regulations with payment schedules exceeding 2 years. The report also discusses those agreements which did not specify the amount of interest the companies would pay on their outstanding balances. The report makes recommendations to the Secretary of Energy to improve DOE's basis for these settlements and to specify interest terms.

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,

J. Dexter Peach
Director

The Department of Energy estimates that about $3 billion of oil companies' alleged violations of the crude oil and petroleum product price controls remain to be resolved. Energy's primary method of resolving such violations has been by negotiating a settlement agreement with each oil company. Some of these agreements have given the oil companies a long-term period (exceeding 2 years) for paying the agreed-upon settlement amount. (See pp. 2 and 3.)

For the long-term payment agreements, the Chairman, Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, asked GAO to

--determine whether Energy had adequate justification for negotiating these settlement agreements and

--calculate the amount of interest on settlement agreements for which Energy had only specified the total settlement amount. (See p. 5.)

BACKGROUND

Pursuant to the Emergency Petroleum Allocation Act of 1973 and the Economic Stabilization Act of 1970, Energy has audited oil companies to determine if they complied with federal pricing regulations which were in effect between August 1973 and January 1981. In other words, did the oil companies charge more for oil than allowed by regulation? These audits were made by Energy's regional offices, which also have the authority to resolve the audit findings by negotiating settlements with the companies. In April 1984 GAO judgmentally selected for review a sample of 10 cases to determine Energy's justification for negotiating long-term payment agreements. At that time Energy had negotiated settlements for cash payments to the federal government of $703 million. Of this amount, $104.8 million represented payments to be made by 59 oil companies over a long-term period. (See pp. 1 to 4.)

RESULTS IN BRIEF

Energy had delegated to its regional offices the authority to settle oil companies' alleged oil overcharge violations. However, it had not established procedures or guidelines for the offices to use to help assure that they adequately analyzed the oil companies' financial conditions. Furthermore, Energy does not adequately document its justification for entering into these settlement agreements. Therefore, GAO could not determine whether Energy's negotiated settlements were justified or equitable or whether the companies would be financially able to meet the payment commitments. (See p. 8.)

In 20 of the 59 long-term settlement agreements, totaling $41.6 million, Energy did not identify the amount of interest included in the negotiated settlements. As requested by the Subcommittee, GAO estimated that this interest was $16.8 million. According to a key Energy official, interest was not identified in these cases because the objective of its regional offices was to negotiate a total amount which represented the most a company was able or willing to pay. The separation of the settlement amount and the interest was considered secondary in importance. (See p. 18.)

PRINCIPAL FINDINGS

The 10 long-term settlement agreements GAO reviewed ranged in value from $65,000 to $32 million and had payment terms ranging from 2.5 years to 15 years. GAO found that each of Energy's regional offices had the authority to enter into these agreements. However, Energy had not issued any procedures or guidelines to help assure that its regional offices adequately analyzed the companies' financial conditions. The regional offices were generally free to decide the amount of each long-term settlement agreement and what documentation was needed to support it.

Justification for Long-term Settlements

For eight of the agreements reviewed, GAO found that Energy had not documented the financial analyses made to justify the terms of these agreements. Although Energy had some documentation on the other two agreements, it was not sufficient for GAO to determine whether the agreements reached were justified. Additionally, in attempting to obtain further information from

Energy officials who negotiated the 10 agreements, GAO found that five officials had left Energy and were no longer available to provide such information. This highlights the need to adequately document the basis for the settlement agreements.

According to Energy, a key factor in determining the settlement amount is the oil company's financial condition and ability to meet the payment commitments. For these reasons, GAO believes it is important that Energy fully document its analysis of the amount and disposition of earnings resulting from alleged violations and the companies' ability to meet long-term payment schedules. (See p. 8.)

Interest Rates

To estimate the amount that should have been considered interest in the 20 agreements where it was not specified, GAO used present value analysis and two discount rates of 6 percent and 10.9 percent which about equals the interest rates Energy charged when it specified interest terms. GAO found that the total settlement amount for the 20 long-term settlements--$41.6 million--included interest totaling $16.8 million. By not separating interest charges from the settlement amounts, Energy overstated to the Congress and the public the amounts it accepted as resolution of the alleged pricing violations. (See p. 18.)

RECOMMENDATIONS

To ensure that its negotiators have adequate justification for future long-term settlements, GAO recommends that the Secretary of Energy

--develop and implement standardized procedures or guidelines for use in negotiating and documenting long-term settlement agreements (see p. 17) and

--issue a written policy requiring that both the principal and interest terms be specified in agreements which settle oil companies' alleged violations. (See p. 21.)

AGENCY COMMENTS

GAO did not request official agency comments on a draft of this report. However, the views of directly responsible officials were sought during the course of our work and are incorporated in the report where appropriate.

Contents

		Page
EXECUTIVE SUMMARY		i
CHAPTER		
1	INTRODUCTION	1
	Prior reports	4
	Objectives, scope, and methodology	5
2	LACK OF DOCUMENTATION PROHIBITS DETERMINING ADEQUATE JUSTIFICATION FOR LONG-TERM SETTLEMENT AGREEMENTS	8
	Lack of guidance and procedures for negotiating and documenting long-term settlements	10
	Conclusions	16
	Recommendation to the Secretary of Energy	17
3	ERA SHOULD SPECIFY THE INTEREST IN ALL LONG-TERM SETTLEMENTS	18
	Conclusions	21
	Recommendation to the Secretary of Energy	21

ILLUSTRATIONS

Figure 1	Oil company settlements requiring payments either into DOE's escrow account or U.S. Treasury as miscellaneous receipts (as of April 30, 1984)	3
Table 1	Data on sample of 10 oil company settlements on which payments were not complete as of April 30, 1984	9
Table 2	Comparison of settlement amounts with discounted values using inputed interest rates	19

ABBREVIATIONS

DOE	Department of Energy
ERA	Economic Regulatory Administration
GAO	General Accounting Office
IRS	Internal Revenue Service

CHAPTER 1

INTRODUCTION

In 1970, as part of an effort to stem the growth of inflation in the economy in general, the federal government froze prices of crude oil and refined petroleum products. In 1973 the government took specific action to regulate the price of crude oil and refined products and, when necessary, to allocate petroleum supplies. In late 1973 and early 1974, the Organization of Petroleum Exporting Countries embargoed crude oil exports to the United States and then dramatically increased the price of its crude oil exports. Consequently, the Congress, attempting to minimize any adverse repercussions, passed the Emergency Petroleum Allocation Act of 1973 (15 U.S.C. 751 et seq.). The act 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 in 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 and allocation regulations to the Federal Energy Administration[1] along with all authority vested in the President by the Emergency Petroleum Allocation Act of 1973. Subsequently, 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. Further, the authority previously granted to the Federal Energy Administration by Executive Order No. 11790 was delegated to the Department of Energy (DOE), effective October 1, 1977.[2]

The Secretary of Energy delegated to the Administrator, Economic Regulatory Administration (ERA), the authority and responsibility to establish and enforce compliance with the pricing and allocation regulations. ERA and the above-mentioned

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

[2]Executive Order No. 12009.

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). Crude oil producers and resellers, petroleum refiners, and refined petroleum product resellers and retailers were subject to the pricing and allocation regulations.

ERA still has the authority and responsibility for (1) identifying violations of petroleum pricing and allocation regulations which occurred during the period of regulation, (2) recovering overcharges, and (3) obtaining restitution for injured parties.

When ERA, through its audits, alleges civil violations of the allocation and/or pricing regulations, it may negotiate a settlement with the oil company, which has been ERA's principal method of resolving such violations. ERA may also resolve the alleged violations by initiating administrative action separate from, or concurrent with, the settlement negotiations. This administrative action includes issuing a proposed remedial order to the company which specifies the alleged violations and recommends remedial action. 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 negotiated, a consent order is written to specify the actions ERA and the company agree will settle the alleged violations. If the parties harmed by the alleged violations are readily identifiable, the consent order would require refunds to such parties. Each consent order is published for the information of the Congress and the public.

When the parties injured by the oil companies' overcharges are not readily identifiable during the settlement, ERA has agreed to several types of distributions as settlement of the oil companies' alleged violations. These distributions which as of March 1985 totaled $1.6 billion have included oil company payments to the U.S. Treasury as miscellaneous receipts, state governments, and DOE's interest-bearing escrow account with the U.S. Treasury. ERA does not have a policy on when to use which type of distribution. Rather, ERA decides on the type of distribution during each settlement negotiation process. Recently, however, most of the distributions have been payments to DOE's escrow account.

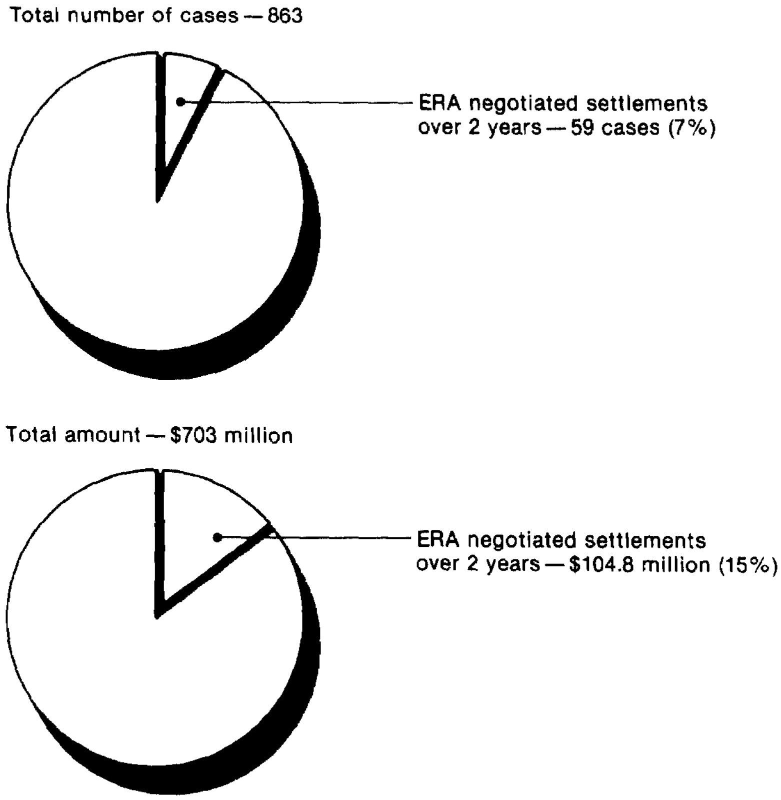
ERA does not maintain statistics on the total amount of alleged violations resolved by these distributions. As of March 1985, however, ERA estimated that about $3 billion in alleged violations remained to be resolved for about 330 cases.

For those settlements which result in payments into either DOE's escrow account or the U.S. Treasury as miscellaneous receipts, ERA has allowed the companies varying time periods to make these payments. ERA considers the payment period to be long term if it covers more than 2 years. ERA officials said that they agree to long-term payment provisions when an oil company is not financially able to pay the total agreed-upon settlement amount within 2 years and such terms would maximize the amount ERA would collect for the alleged violation. ERA has not used such long-term payment provisions for settlements with the 35 major refiners.

Figure 1 below shows, as of April 30, 1984, the number of cases and the dollar amount of the cases in which the oil companies have a long-term payment period compared with cases in which payment is required in 2 years or under.

FIGURE 1

Oil Company Settlements Requiring Payments Either Into DOE's Escrow Account or U.S. Treasury as Miscellaneous Receipts (As of April 30, 1984)



Source: Magnetic computer tapes obtained from DOE's Office of the Controller.

As shown in figure 1, 59 of the 863 cases involving payments into either DOE's escrow account or the U.S. Treasury as miscellaneous receipts were negotiated by ERA with a long-term payment schedule. These 59 cases accounted for $104.8 million of the

$703 million to be paid into either the escrow account or the U.S. Treasury. Fifty-five of the 59 cases and 667 of the 863 cases required funds to be deposited into DOE's escrow account. The remaining funds are required to be deposited into the U.S. Treasury as miscellaneous receipts.

In addition to the payment amounts discussed above for long-term payments, ERA may specify and collect interest. Prior to February 1980, these rates were generally based on the rate the Internal Revenue Service (IRS) used in computing tax liability. After that date, these rates were generally based on the prime interest rate. ERA changed from the IRS rate to the prime interest rate because the IRS rate was only revised every 2 years, which ERA believed did not adequately reflect ERA's goal of full restitution for violations during a period of rising interest rates.

ERA's headquarters has the overall responsibility for enforcing its regulations. In its enforcement of the regulations, ERA distinguishes between the 35 major refiners and all other cases. Although the field offices conducted the audit work for the major refiners, headquarters is directly responsible for settling their cases. ERA's field offices were generally responsible for auditing the thousands of other oil companies in their regions, preparing proposed remedial orders, and settling the companies' alleged violations. ERA's work load had decreased from about 2,600 cases in October 1977 to about 330 cases in December 1984. When we started our review in March 1984, ERA had five field offices (Dallas, Houston, Kansas City, Philadelphia, and Tulsa). ERA had previously closed four offices (Atlanta, Denver, Los Angeles, and San Francisco) as a result of the work load decreasing in each of the offices. If any work remained to be completed at these offices when they were closed, it was transferred to another office. Subsequently, ERA closed its Kansas City and Philadelphia field offices on October 19, 1984, and its Tulsa field office on February 15, 1985, for the same reason.

PRIOR REPORTS

We have issued several reports dealing with different aspects of ERA's negotiated settlement process. These reports have discussed items such as

--the restitutional value of negotiated settlement provisions[3] and

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

--the adequacy of ERA's documentation for ensuring that the negotiated settlements are equitable.[4]

The DOE Office of Inspector General also issued a report on ERA's management of installment payments (including long-term payments) resulting from negotiated settlements. In its November 30, 1983, report,[5] the DOE Office of Inspector General concluded that ERA had not (1) always specified the interest to be charged on installment agreements, (2) accrued or collected the interest it had specified on some installment agreements, and (3) charged or collected interest on delinquent installment payments as prescribed by the U.S. Treasury and DOE. Based on a statistical sample of these settlement agreements, the Inspector General estimated that ERA had understated accrued interest due on installment payments by $3.7 million and delinquent accounts by $543,000.

The Inspector General recommended that ERA (1) identify and collect the amount of outstanding interest and that appropriate policies and procedures be implemented to assure that interest is properly accrued and collected in the future and (2) explicitly identify the interest to be charged on all future installment payments. Although ERA generally agreed with the recommendations, it disagreed with the Inspector General's projections on the amounts of interest due. As of May 1985, the Inspector General was in the process of writing a follow up report on these matters.

OBJECTIVES, SCOPE, AND METHODOLOGY

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

--determined whether ERA had adequate justification for negotiating settlement agreements with long-term payment provisions and

--calculated the amount of interest on those agreements for which ERA had only specified the total settlement amount.

We conducted our audit work at DOE headquarters in Washington, D.C., which has the primary responsibility for overseeing the settlement of all alleged violations and

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[4]Improvements Needed in the Department of Energy's Petroleum Pricing and Allocation Compliance Program (GAO/RCED-84-51, Apr. 18, 1984).

[5]Report on Audit of the Petroleum Pricing Violation Escrow Account (DOE/IG-0201, Nov. 30, 1983).

maintaining records for monitoring the payments into the escrow account. In making our analysis, we obtained a magnetic tape from DOE's Office of the Controller which contained statistical data as of April 30, 1984, on all settlements requiring payments either into DOE's escrow account or the U.S. Treasury as miscellaneous receipts. This data included the scheduled amounts and dates of payments but did not contain data on any interest required by the settlement agreement.

We analyzed the data on this tape to determine how many payment schedules were long term, exceeding 2 years. From the tape, we identified 59 cases ($104.8 million) that were negotiated settlements with long-term installment payments. We compared the 59 cases with their settlement agreements to verify the settlement amount and that the scheduled payments exceeded 2 years. Because the tape did not contain information on interest charges, we obtained from the settlement agreements the interest rate for the 39 cases with specified interest and verified that the other 20 cases ($41.6 million) did not have interest specified. We also obtained from the settlement agreements the date they were signed. As of April 30, 1984, the oil companies had not yet completed their payments for 41 ($70.9 million) of these 59 installment agreements.

To determine if ERA had adequate justification for negotiating settlement agreements with long-term payment provisions, we analyzed the files on 10 of the 41 open long-term settlement agreements. The settlement agreements for these 10 cases total $44.4 million (63 percent of the $70.9 million for the 41 cases). We also analyzed applicable policies, procedures, correspondence, compliance documents, and statistical reports and discussed these long-term settlement agreements with ERA headquarters and regional officials to obtain their perspective on these agreements.

We considered several factors in selecting the 10 long-term settlement agreements to be analyzed. First, we were interested in cases of varying dollar amounts. We reviewed six cases with large dollar amounts ($800,000 to $32 million) and four cases with smaller dollar amounts ($65,000 to $425,000) to determine if there were any major differences in how ERA handled these smaller cases. Second, we wanted to analyze cases from a cross-section of the ERA offices. Therefore, we selected the only headquarters negotiated long-term agreement still open and 7 of the 25 open cases from four of the five field offices that were open at the time of our review (Dallas did not have any open cases). Because we also wanted to include 1 of the 16 open cases from the four ERA field offices that had been closed prior to the start of our review, we initially selected one of the San Francisco field office's cases. Because ERA had difficulty in locating the documentation for this case, we requested and received the documentation on another

San Francisco case. Subsequently, ERA provided the documentation on the first case we requested. As a result, we reviewed both cases.

Our cases were not statistically selected; therefore, the results of our work cannot be projected to all of ERA's long-term cases. Because our work primarily involved ERA's procedures in negotiating and documenting long-term settlement agreements, we believe the results are indicative of ERA's overall operation because our discussions with ERA officials covered ERA's policies and procedures for all long-term settlements.

Prior to computing the discounted value of the settlement agreements with long-term payment provisions in which ERA did not specify the amount of interest included in the settlements, we examined DOE's policies and procedures on charging interest and discussed this subject with ERA headquarters officials. For the 20 cases in which ERA only specified the total amount to be paid without identifying what portion of the total was interest, we calculated the discounted[6] present value of these settlements to determine the extent that the principal amounts may have been overstated. In computing the present value for these 20 cases, we used two rates in our calculation--the IRS rate for cases settled before February 1980 and the prime interest rate for cases settled after that time. These rates approximately equal the interest rates ERA charged when it specified interest terms during those periods.

For the 39 cases that specified interest terms, the rate of interest was part of the negotiation process. Because we are not privy to the negotiations nor are there records of such meetings, we could not evaluate the adequacy of the interest rates ERA charged.

We discussed our findings with agency program officials and included their comments where appropriate. However, in accordance with the requester's wishes, we did not obtain the views of responsible officials on our conclusions and recommendations, nor did we request official agency comments on a draft of this report. With that exception, our work was performed in accordance with generally accepted government auditing standards. Our work was performed from March 1984 to February 1985.

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[6]Discounting determines the amount of money which, if invested today at a selected interest rate, would be sufficient to meet the settlement amount.

CHAPTER 2

LACK OF DOCUMENTATION PROHIBITS DETERMINING ADEQUATE JUSTIFICATION FOR LONG-TERM SETTLEMENT AGREEMENTS

As of April 30, 1984, ERA had negotiated 59 settlement agreements with oil companies--41 were still open (final payment not yet made)--which had payment terms exceeding 2 years.[1] ERA does not have standardized procedures or guidelines to use in negotiating long-term settlement agreements, thus leaving to its individual field offices the responsibility of determining the type and amount of financial analyses and documentation needed to justify the terms of the settlements. On the basis of our analyses of 10 of the 41 open agreements, we found that ERA had not documented the analyses that its officials said were made to justify the terms of these settlement agreements. Also, in one case we found that ERA had not made an analysis in deciding on the terms of the settlement agreement. Therefore, we could not determine from the documentation available whether ERA had adequate assurance that the long-term settlement agreements equitably resolved these companies' alleged violations and that the companies would be financially able to meet these long-term commitments.

The following table contains data on the 10 cases we analyzed.

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[1]According to ERA's Director of Financial Management, as of April 1985, ERA had negotiated an additional five settlement agreements with payment terms exceeding 2 years.

Table 1

Data on Sample of 10 Oil Company Settlements on Which Payments Were Not Complete as of April 30, 1984

Company[a] name	Consent order date	Alleged violation	Principal[b] amount of settlement	Installment interest specified	Payment schedule
Company A	11-79	$ 2,271,245	$ 394,596	no	2 years, 6 mos.
Company B	2-80	1,344,479	208,239	no	5 years
Company C	4-81	1,482,637	800,000	yes	4 years
Company D	7-82	12,896,233	1,550,000	yes	3 years, 9 mos.
Company E	1-83	25,642,454	2,800,000	yes	5 years
Company F	4-83	107,867,959	17,582,646	no	15 years
Company G	4-83	582,780	65,000	yes	5 years
Company H	7-83	14,679,488	3,406,496	no	9 years
Company I	9-83	705,325	200,000	yes	5 years
Company J	2-84	8,666,127	900,000	yes	5 years
Total		$176,138,728	$27,906,977		

[a]We have not identified the companies by name because our subsequent discussion of some of these companies contains proprietary data.

[b]The amounts we used for those cases where installment interest was not specified are the principal amounts we computed using present value analysis. The amounts for those cases specifying interest terms are the principal amounts stated in the consent orders. The total amount as stated in the consent orders for all 10 cases is $44,440,000.

As shown in the above table, we estimate that ERA settled the 10 cases for principal amounts totaling $27.9 million, compared with the $44.4 million stated in the consent orders. The difference is the interest that we computed for those settlement agreements that did not separately identify the interest rate. (The $44.4 million is about 42 percent of the $104.8 million involved in settling the 59 cases with long-term payment terms.) The table also shows that six of the settlements specify interest payments, while four do not. In addition it shows that the payment schedules range from 2.5 years to 15 years.

LACK OF GUIDANCE AND PROCEDURES FOR NEGOTIATING AND DOCUMENTING LONG-TERM SETTLEMENTS

ERA has not established standardized procedures to guide its negotiators in achieving long-term settlements. ERA's Deputy Administrator told us that the ERA regional offices had the authority to enter into settlements and did not operate under binding procedures or any other guidelines as to the appropriateness of the installment payments or interest terms. Rather, each office was free to evaluate the appropriateness of time payments in view of its assessment of the oil companies' financial condition. Also, each office was free to decide on the level of documentation to be maintained in support of settlement agreements. This policy, according to the Deputy Administrator, was dictated by the large volume of cases in existence prior to 1982 and the decentralized organizational structure maintained by ERA at that time.

ERA's Special Counsel told us that the criteria for negotiating settlements were discussed in the June 1983 ERA field directors meeting. This criteria was summarized in his August 23, 1983, memorandum to the ERA Administrator as follows

--review of certified financial statements for the violation years through the current years,

--review of income tax returns,

--tracing of excess profits through expenditures or salaries to officers or shareholders,

--review of financial statements and tax returns for principal individuals (and immediate families) where there is an apparent case for individual liability,

--review of net worth balance sheets with particular attention given to book values versus fair market values and investments or interests held in other going concerns,

--likelihood of future ability to pay even if such a settlement is effected and the likelihood of bankruptcy even if settlement is effected,

--the firm's ability to pay compared to the realistic and maximum potential values of the case,

--the taxes actually paid on the excess profits,

--the degree and duration of apparent wrongdoing,

--the present value of the settlement if it is for term payment without added interest, and

--a healthy measure of skepticism.

The overall objectives of ERA's criteria, as stated above, show that the negotiators should obtain and analyze the companies' financial records to establish an understanding of their past, present, and future financial conditions. However, ERA's memorandum is not specific as to the methods to be used in accomplishing these objectives. To help assure that negotiators adequately analyze the companies' financial conditions, ERA should establish specific written guidance on (1) the types and extent of financial analyses that are required before a long-term settlement is finalized and (2) the documentation that should be maintained in support of the settlement agreements.

In our review of ERA's files on the 10 cases shown in table 1, we found that ERA had not adequately documented the analyses it made to justify the settlement terms. In the absence of such documentation, we could not evaluate the adequacy of the analyses supporting these settlements. Our discussions with some of the negotiators show that various approaches were used to support the settlements. For example, in one of these cases, ERA did not analyze the company's financial statements but rather relied on the company's verbal statements in deciding upon the terms of the settlement agreement.

In order for ERA to obtain the necessary financial information from oil companies when negotiating settlement agreements with long-term payment provisions, good accounting principles require that ERA systematically analyze oil companies' financial records. These analyses should include (1) determining the amount and disposition of each company's earnings resulting from the alleged violations by analyzing financial data from the regulation period to the period in which a settlement is negotiated, (2) establishing each company's present financial position by examining ratios between financial statement line items, and (3) determining each company's ability to make long-term payments by developing financial ratios which indicate relationships between reported line items in the most current financial statements to industry standards and the company's performance since the beginning of the regulation period. Consistent and systematic use of these ratios and trend analyses can give the negotiator a reasonable picture of each company's past and an ability to make some judgments on the future earning capacity of each company. Good management principles further dictate that any analysis that ERA conducts be adequately documented in order that a permanent record be maintained which specifies and explains the factors ERA considered and the rationale behind the terms of the negotiated settlement.

For 4 of the 10 settlement agreements we reviewed (companies A, C, D, and G), ERA's files did not contain (1) financial statements on the four companies and (2) documentation evidencing what analyses ERA made to justify the settlement terms. We discussed company G with the then Deputy Director of ERA's Kansas City Office, which had responsibility for this case. He said that ERA had not requested the company to submit financial statements. Rather, ERA agreed to the settlement terms on the basis of the company's oral statements about its economic condition and cash-flow problems. ERA did not make an analysis to verify the company's statements. We were unable to discuss companies A, C, and D with the negotiators because they were no longer with ERA. This points out the need for adequately documenting the basis for settlement decisions because the basis no longer exists within ERA.

We discussed these four cases with ERA's Director of Enforcement Programs.[2] He said that the lack of financial statements in ERA's files does not necessarily mean that ERA did not analyze the company's financial condition. The ERA auditors could have reviewed the company's financial statements without making copies of them. Concerning the lack of documentation showing what analyses ERA made, the director said that the ERA regional office might have decided that the amount of the alleged violation and settlement did not warrant documenting its analyses. He also said that some of ERA's regional offices did a better job of examining and documenting the companies' financial condition than others. In this regard, he said that the Dallas, Houston, and Tulsa regional offices generally did a better job than the other regional offices. (These three offices did not have responsibility for any of these four cases.)

For the other six cases (companies B, E, F, H, I, and J), the ERA files contained the companies' financial statements. However, these financial statements were generally only for the 2 years immediately preceding the period during which the settlement negotiations were held and therefore generally did not cover the period when the alleged violations occurred. Also, for four of the cases (companies B, H, I, and J), the ERA files did not contain documentation evidencing what analyses ERA made to justify the settlement terms. The documentation needed for company J is different than the other companies we looked at because the Director of ERA's Tulsa Regional Office (who had responsibility for negotiating the settlement with company J), told us that, at the time of settlement, the banks holding security interest in company J had taken control of the company's operations. Although

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[2]Prior to ERA's January 17, 1985, reorganization, this person was ERA's Deputy Special Counsel. The Special Counsel handles all negotiations relating to settlement of enforcement matters.

the banks were under no obligation to repay the overcharges to DOE, they did agree to pay $900,000 over a 5-year period. Rather than documenting the company's financial condition, ERA should have fully documented the above facts.

The Director of ERA's Houston Regional Office, which had responsibility for negotiating settlements with companies H and I, told us that the owners' personal resources were taken into account in determining the companies' ability to pay. She also said that ERA considered how both companies' gross profits were spent during the period of price controls. However, we found nothing in ERA's files on company I to support these statements. Company H provided ERA a list of how the gross profits were spent; however, ERA's files did not contain any documentation evidencing what analysis ERA had made of the data provided. We were unable to discuss company B with the responsible ERA official because he was no longer with ERA.

For companies E and F, the files contained documentation showing that ERA had analyzed the financial statements. However, we could not determine whether ERA's analyses were adequate because the files did not contain documentation showing whether ERA addressed the following aspects of each case.

ERA agreed to a $2.8 million settlement with company E for $25,642,454 of alleged violations. ERA's justification for this settlement was that the company's financial condition at that time (April 30, 1982) would not allow it to pay more than the $2.8 million over a 5-year period. The file on this case supports ERA's evaluation of the company's financial condition at that time. However, the files lacked any evaluation of the company's operations during the regulation period. For example, the case file contains documents showing that the company's net income before taxes for the period May 1, 1973, through April 30, 1981, (basically the period of price controls) was either $43 million or $71.9 million depending on the inventory valuation method used. For the last 2 years of this period, the company's net income was $8 million or $33.3 million. For the year ending April 30, 1982, the company had a net loss of either $.5 million or $19.4 million. According to ERA's Director of Enforcement Programs, company E filed for bankruptcy in February 1985. The ERA Director said that company E will not liquidate its assets, but will continue operations and pay its indebtedness over an extended period of time.

We reviewed ERA's files on company E, and we could not find any documentation showing whether ERA had addressed (1) that the company had millions of dollars of profits during the period when federal price controls were in effect to limit profits, but had losses once prices were decontrolled and (2) what happened to the profits earned during the period of price controls. We believe that ERA should have documented its compliance with its criteria for reviewing certified financial statements for the violation years through the current years and for tracing companies' excess profits (see pp. 10 and 11). In tracing these profits, ERA should have documented its determination of what happened to the profits--were they reinvested in the company, distributed to the owners (shareholders), or invested in other interests? Depending on how the profits were used, ERA might have had a better basis for negotiating the amount of settlement and for determining whether the owner should personally be held responsible for assuring that the settlement amount is paid. We were unable to discuss this case with the responsible ERA negotiating official because he was no longer with ERA.

In April 1983 ERA agreed to a $32 million[3] settlement with company F for $107.9 million of alleged violations. In addition, ERA entered into a separate agreement with the majority owner of the company. Basically, the terms of this separate agreement require this owner to submit to DOE one-third of his combined personal and business income (after taxes) during the 5-year period January 1, 1984, through December 31, 1988, that exceeds $13.5 million, up to a maximum of $10 million. According to the files for this case, the basis for these settlements was that (1) the company's present financial condition (April/May 1983) would not allow it to pay more than $32 million over a 15-year period and (2) the majority owner had received a significant amount of the company's profits. ERA's file on this company shows that the company's crude oil sales produced $134 million of net profit before taxes for the period December 1977 through December 1980. (Company F was incorporated on November 17, 1977, and price controls were lifted in January 1981.) Of this net profit, the owners' compensation totaled $12.5 million, of which $8.2 million was the majority owner's. According to the Director of ERA's Houston field office, which had responsibility for settling this case, factors ERA considered in negotiating the settlement included the company's capability to pay whatever amount was finally agreed upon and the personal assets and liabilities of the company's majority owner.

Our review of ERA's file on this settlement disclosed that ERA had done some analyses of the company's and the majority owner's financial data for the period of price controls. However, the file did not contain adequate documentation and analyses to give the overall financial picture of the company. Also, the files did not contain an explanation of why ERA decided that the settlement agreement with the majority owner would not require him

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[3]The $32 million is the total settlement amount ERA negotiated but did not specify the installment interest in the settlement agreement. We estimate the principal amount to be $17.6 million.

to make any contributions to the settlement until his income exceeded $13.5 million over 5 years (an annual average of $2.7 million). During the period of price controls, the majority owner received $8.2 million (an annual average of $2.7 million) from the company. Therefore, the agreement with the majority owner allows him the same rate of compensation that he received during the period of his company's alleged violations of $107.9 million.

Without documentation for 8 of the 10 cases we reviewed, we could not evaluate the adequacy of ERA's financial analyses of these companies, including the companies' ability to make the long-term payments. However, the payment history of several of the 59 companies with long-term payment periods suggests that ERA could have better analyzed these companies' financial condition. For example, ERA settled with company C in April 1981 for $800,000 to be repaid in 48 monthly installments of $16,667 plus interest. However, company C repaid less than one year's installments, $188,499, before filing for bankruptcy on April 9, 1984. As of February 1985, 8 of the 59 companies with long-term payment periods had filed for bankruptcy, and an additional 12 were delinquent in making installment payments, of which 5 were more than 1 year delinquent. ERA's Director of Enforcement Programs acknowledged that collection from some of these companies is a problem. In our opinion, this demonstrates a need for a thorough analysis of the companies' financial condition.

We believe that the absence of adequate documentation of analyses on all 10 settlement agreements was because ERA lacked adequate written policies or guidelines for its negotiators to use in agreeing to and documenting settlement terms with the oil companies. ERA's Deputy Administrator told us that the ERA regional offices had the authority to enter into these settlement agreements and did not operate under binding procedures or any other guidelines as to the appropriateness of installment payments or interest terms. Rather each office was free to evaluate the appropriateness of time payments in view of its assessment of the oil company's financial condition. Also, each office was free to decide on the kind of documentation needed to support the companies' assertions of inability to make full payment.

Because the settlement with company F was for a 15-year payment period, ERA's congressional oversight Subcommittee criticized it during hearings the Subcommittee held shortly after the settlement. About the time this settlement was signed in April 1983, ERA began requiring its regional offices to obtain headquarters approval before finalizing any long-term settlement agreement. (Prior to this time, headquarters approval was only required for crude oil reseller cases which, except for the major refiner settlements handled by ERA headquarters, have the largest amount of alleged violations.) ERA's Special Counsel told us that as part of obtaining headquarters approval, ERA began requiring justification memorandums, containing the reasons why ERA had agreed to the settlement terms, to be prepared for each long-term agreement. However, it was not until the June 1983 field director's meeting that writing a justification memorandum was an official requirement. He said that the reason company G did not prepare a justification memorandum was that its settlement was in April 1983, about the time ERA began to improve its internal controls but before an official requirement was established. At that time, ERA was concentrating on the cases with the largest dollar amounts.

Of the 10 long-term settlement cases we reviewed, ERA had prepared justification memorandums on 4, all of which were crude oil resellers. (Companies F, H, I, and J were crude oil resellers; companies A, B, and G were resellers-retailers; and companies C, D, and E were refiners.) The memorandums gave a history of the settlement negotiations and the general reasons why the negotiator believed that the settlement amount was justified. In our opinion, however, these memorandums did not provide adequate justification for ERA agreeing to the settlement terms. The memorandums did not contain the results of ERA's financial analyses of the companies. In addition, except for company F, the memorandums did not specifically explain why ERA only concentrated on the then current financial position of the company, without analyzing what happened to profits earned by the company during the period of price controls. Also, with the exception of company F, the memorandums did not address to what extent the owner's income was considered in the settlement process.

CONCLUSIONS

ERA has no standardized procedures or guidelines for its settlement negotiation process with oil companies. Our review of ERA's files on 10 long-term settlement agreements and discussions with agency officials disclosed that ERA's process for settling these cases does not appear systematic and coordinated. As a result, the cases we reviewed ranged from ERA relying solely on the company's oral statements to ERA documenting some major analyses of the financial history of the company for the period of price controls. We believe that procedures and guidance specifying the methods to be used to obtain a thorough understanding of the company's past, present, and future financial condition is essential in negotiating settlements with long-term payment provisions.

Although ERA officials said that they made sufficient analyses to justify the terms of these settlement agreements, documentation in ERA's files did not support the officials' position. No written guidance exists specifying the requirements for adequate documentation. Without adequate documentation, we could not determine whether ERA has adequate assurance that the long-term settlements equitably resolved these companies' alleged violations and that the companies would be financially able to meet these long-term commitments. In addition, we were unable to discuss 5 of the 10 cases with ERA's negotiators because they were no longer with ERA. This further emphasizes the need for documenting the basis for settlement decisions because over time the knowledgeable personnel may no longer remain in ERA. To assure that such documentation is maintained for the settlement agreements, we believe that ERA needs written procedures and guidelines for documenting the basis used in negotiating long-term settlement agreements.

In addition to the oil company cases already settled by ERA, as of March 1985, there were about $3 billion in unresolved, alleged violations. ERA could resolve these alleged violations by negotiating a settlement or taking legal and/or administrative action. The extent to which ERA resolves these alleged violations by negotiated settlements with long-term payment schedules will impact the significance of the results of our evaluation.

RECOMMENDATION TO THE SECRETARY OF ENERGY

To provide adequate assurance that the long-term settlement agreements are equitable and that the companies are able to make these long-term payments and to provide the opportunity to review the basis for these decisions, we recommend that the Secretary of Energy have the ERA Administrator develop and implement written standardized procedures or guidelines that require (1) adequate analyses of the oil company's current and past financial condition, (2) resolution of any questions, concerns, and/or inconsistencies about the company's past financial history and the owners' compensation, and (3) adequate documentation of the analyses performed and the basis for the ultimate agreements.

CHAPTER 3

ERA SHOULD SPECIFY THE INTEREST IN

ALL LONG-TERM SETTLEMENTS

Of the 59 settlement agreements ERA negotiated with oil companies with payment terms exceeding 2 years, 20 totaling $41.6 million did not specify how much of the total dollar amount settling the oil companies' alleged violations was principal and how much was interest. These 20 agreements were negotiated by five[1] of ERA's field offices. ERA's Director of Enforcement Programs told us that the amount of interest was factored into the 20 cases totaling $41.6 million, but was not separately identified. Based on our present value analysis, we estimate that $24.8 million was the principal amount which settled these alleged violations. We believe that ERA should specify the interest terms in all settlement agreements with long-term payment schedules so that the principal amount which settles the alleged violations is known and is not overstated by including interest.

For the other 39 cases, ERA specified both the principal amount and the interest terms. The interest rates in these 39 agreements ranged from 6 percent (approximates IRS rates used to compute tax liability) to 20.3 percent (approximates the maximum prime rate charged). ERA changed from the IRS rate to the prime interest rate in February 1980 because the IRS rate was only revised every 2 years, which ERA believed did not adequately reflect ERA's goal of full restitution for violations during a period of rising interest rates.

Table 2 shows the relative size of the 20 settlement agreements that did not specify interest terms and the results of our estimate of the present value of these agreements.

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[1]These five field offices were Atlanta, Houston, Kansas City, Philadelphia, and Tulsa.

Table 2
Comparison of Settlement Amounts with Discounted Values Using Imputed Interest Rates

Companies	Settlement Agreement Date	Amount	(Percent)	Present value of settlements[a] IRS Rate (6 percent)	Prime Rate (10.9 Percent)
		---------------(I n	M i l l i o n s)---------------		
Company F	4/83	$32.0	(76.9)		$17.6
Company H	7/83	5.3	(12.7)		3.4
Subtotal		37.3	(89.7)[b]		21.0
13 other companies subject to IRS rate	5/79 to 2/80	3.3	(7.9)	$3.0	
5 other companies subject to prime rate	2/80 to 7/83	1.0	(2.4)		0.8
Total		$41.6	(100)	$3.0	$21.8
Present value of all 20 settlements				$24.8	

[a]The present values were computed using the dollar amounts specified in the settlement agreements without converting them to a common-year basis. In our opinion such a conversion was not necessary because the present values shown are representative enough to allow a valid comparison with the stated settlement amounts. The interest rates we used were the IRS rate (6 percent) for each company with a settlement agreement dated prior to February 1, 1980, and a weighted average prime rate of interest (10.9 percent) for each company with a settlement agreement dated on or after that date. The cutoff date is the date ERA switched from the IRS rate to the prime rate for those settlement agreements in which interest terms were specified. (See p. 18.)

[b]Does not total due to rounding.

As shown in the above table, companies F and H, both crude oil resellers, accounted for about 90 percent of these 20 settlements, with company F alone accounting for about 77 percent. The other 18 companies accounted for about 10 percent.

The last two columns of table 2 contain the results of our estimate of how much of the settlement agreement amounts represented payment of principal for alleged violations. We arrived at our estimate by using present-value analysis and interest rates which are approximately equal to the rates ERA used for those settlement agreements with specified interest terms. As shown in the last two columns, the total present value of the total settlement agreement amount ($41.6 million) is $24.8 million (60 percent). The remainder ($16.8 million) is our estimate of how much of the $41.6 million should be considered interest. Assuming that interest was factored into the settlements, the principal amounts which represented payment of alleged violations may have been significantly overstated.

We discussed these 20 cases with ERA's Director of Enforcement Programs. He explained that it is ERA's unwritten policy to consider interest when negotiating oil company settlements; however, the policy does not require specifying the amount of interest. In some cases, ERA's regional offices did not specify the rate of interest they considered because their primary objective was to negotiate a total payment amount which represented the most a company was able or willing to pay. Therefore, although interest was a consideration, the overriding concern was the total amount to be repaid. He did say, however, that in any future crude oil reseller cases (collectively the largest dollar amounts) or cases involving large dollar amounts, ERA would specify the amount of interest agreed upon in the settlements.

We recognize that the total amount of payment is a product of ERA's negotiations with the oil company and represents the most ERA believed it could obtain from the company. (In ch. 2 we discuss ERA's basis for agreeing to these total amounts.) However, as shown in table 2, the actual dollar value of the principal is less than the amount stated by ERA. Using company F as an example, the estimated settlement principal amount (present value) is $17.6 million (55 percent) of the $32 million to be paid. Therefore, by not specifically stating the interest, ERA may have overstated the actual settlement principal amount of this case by $16.8 million.

The significance of ERA not specifying interest terms could increase beyond these 20 settlement agreements. As of March 1985, ERA estimated that there were $3 billion in unresolved alleged violations. We have no basis for estimating how much, if any, of these alleged violations ERA will resolve by settlement agreements with long-term payment schedules. However, unless ERA requires that the interest terms be specified, the potential exists for principal values of future settlements to be overstated.

CONCLUSIONS

Using present-value analysis, we estimate that $16.8 million of the $41.6 million represents interest. We believe that ERA should specify the interest terms of each settlement agreement so that the principal amount representing resolution of the alleged violations is known. When the total settlement amount includes unspecified interest, such amount overstates to the Congress and the public the principal value of the settlement agreement.

RECOMMENDATION TO THE SECRETARY OF ENERGY

To ensure that each of DOE's agreements accurately state the terms of the settlement, we recommend that the Secretary of Energy direct the ERA Administrator to issue a written policy requiring that both the principal amount which settles an oil company's alleged violations and the interest amount and terms be specified in the settlement agreement. The ERA Administrator should implement this policy for those cases currently being negotiated and for any future settlement negotiations. Our recommendation is consistent with the DOE Inspector General's recommendation that ERA explicitly identify the interest to be charged on all future installment payments (see p. 5).

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