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STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
HOUSE COMMITTEE ON ENERGY AND COMMERCE

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss our review of ~~the Department of Energy's~~ (DOE) efforts to enforce ~~the~~ crude oil pricing regulations ~~established under the authority~~ of the Emergency Petroleum Allocation Act of 1973. Although crude oil and refined products were deregulated by the President on January 28, 1981, the regulations will continue to have an impact on DOE and on the Internal Revenue Service's (IRS) efforts to administer the Crude Oil Windfall Profit Tax.

Over the past several years, we have done considerable work in the DOE enforcement area. A few days ago, we reported to this Subcommittee on our most recent work, and I understand the report is to be released today. The principal matters that I will be addressing today are:

--DOE's problems in attempting to resolve billions of dollars in alleged pricing violations and how these problems affect IRS' ability to enforce the Crude Oil Windfall Profit Tax

--Impact of proposed budget cuts on DOE compliance activities

--Improvements needed in DOE's settlement process.

I will also present our recommendations in each of these areas.

AUDITS DISCLOSED BILLIONS IN VIOLATIONS

Our review covered DOE's audits of the 35 major refiners and the crude oil resellers from October 1977 through September 1980. We found that DOE has made considerable improvement in its audit coverage of these two groups.

The Office of Special Counsel, which was established in December 1977 to audit the 35 major refiners, set completion goals of December 1979 for the 15 largest refiners and December 1980 for the remaining 20 major refiners. As of October 1980, with one exception, it had completed audits of company activities for the period 1973 through 1976 and had substantially completed the audits for the period 1977 through 1979.

Special Counsel had alleged approximately $10.8 billion in violations by the major refiners, of which $9.4 billion remained outstanding as of October 1980. However, because of the complexity of the audits and the fact that not all of the violations result in overcharges to customers, Special Counsel is unable to show the full impact of the alleged violations on the prices charged to the major refiners' customers.

The Office of Enforcement has given crude oil reseller audits its second highest priority with only the investigation of possible criminal violations receiving greater emphasis. It had identified over $500 million in alleged crude oil reseller violations. This is almost one-fourth of the total alleged violations of $2.3 billion for all the programs reviewed by that office as of September 30, 1980. Although 14 of DOE's 36 notices of probable violation were over 1 year old as of December 1, 1980, the Office of Enforcement had not issued proposed remedial orders against the companies to resolve the violations. Unless the companies are willing to negotiate settlements of the alleged violations, DOE would not be able to resolve them without taking this action. We are, therefore, recommending that DOE expedite its efforts to issue proposed remedial orders.

Since 1977, DOE has negotiated consent orders with 10 crude oil resellers totalling about $32.9 million in refunds and an additional $4.7 million in civil penalties. However, all but two of these consent orders are associated with the Department of Justice's criminal prosecutions rather than strictly DOE's enforcement activities. These two consent orders amounted to only about $1.1 million in refunds and no civil penalties.

DOE'S ABILITY TO RESOLVE VIOLATIONS IS LIMITED BY OIL COMPANY CHALLENGES

The original oil pricing regulations were written

hastily in an effort to control domestic inflation and ensure a fair allocation of limited supplies of crude oil. This resulted in some regulations being incomplete and not immediately applicable to actual conditions and circumstances.

DOE has acted to make its regulations complete and comprehensive. However, because of the enormous dollar amounts involved, the oil companies have challenged DOE. This has resulted in at least 220 civil cases involving DOE's enforcement of its pricing regulations. These cases include appeals from DOE administrative action and company and DOE initiated law suits. DOE has attempted to reduce the cost and time involved in litigating these cases by negotiating settlements with the oil companies. Of over $13 billion in alleged violations, about $4 billion had been settled as of January 1981. Administrative and court litigation could take years to resolve, having implications not only for the phaseout of DOE's enforcement efforts but also for the IRS' enforcement of the Crude Oil Windfall Profit Tax Act of 1980.

Because IRS has adopted DOE's crude oil production regulations and definitions to enforce the Windfall Profit Tax Act, the legal challenges discussed above could also have a profound effect on the tax program. The definition of "stripper well," for example, is fundamental to the petroleum pricing program and to the windfall profit tax because its application sets the basis for the price a producer could charge for crude oil and the taxable income

a producer must recognize on crude oil sales. This definition among others, however, is now the subject of controversy.

Consequently, these challenges could cause delays in the enforcement process and possibly void the regulations themselves. To minimize these enforcement problems, we are recommending that the Commissioner, IRS, conduct a study to determine the potential effect that successful legal challenges to DOE's regulations could have on IRS' ability to enforce the Windfall Profits Tax Act. IRS should then issue regulations that reflect the changes required by its study.

BUDGET CUTS COULD SERIOUSLY IMPAIR DOE'S EFFECTIVENESS

DOE prepared a 5-year plan for phasing out the compliance programs following September 30, 1981, the original scheduled date for deregulation. The plan assumed the Office of Special Counsel would complete its audits during fiscal year 1982, but would continue litigation through fiscal year 1984 and in some cases beyond that year. The plan also assumed that the Office of Enforcement would complete its audits during fiscal year 1983, but litigation and special investigations would continue through fiscal year 1986.

However, the Office of Management and Budget (OMB) has proposed cutting the combined personnel budget for the Office of Special Counsel and Office of Enforcement in fiscal year 1982 from the $46 million proposed by the previous Administration to $12 million. This would reduce the enforcement staff from 886 to approximately 235. The fiscal year 1981 compliance budget was $67 million, and as

of March 7, 1981, the DOE compliance staff totaled 1,366.

While we agree that a budget reduction in this area is justified, we believe that such a drastic cut could seriously impair DOE's ability to enforce the compliance program. We question whether these cuts are based on a workload analysis that adequately considered the orderly resolution of the outstanding violations and litigation. Such a large fiscal year 1982 budget cut could also have adverse effects on DOE's enforcement program in fiscal year 1981 depending on how DOE decides to reduce its staff levels.

For example, costs associated with personnel terminations would clearly be necessary expenses under ERA's annual appropriations available for salaries and related expenses. Lump sum leave payments would be chargeable to the fiscal year appropriation available at the time the employees' employment was terminated. Severance pay, on the other hand, would be chargeable on a biweekly basis to the fiscal year appropriation available for the particular 2-week period involved pursuant to OMB Circular A-34.

Examples of the many questions that need to be answered by DOE to determine exactly how the budget cuts will impact on its efforts to effectively deal with the many unresolved violations, include:

--Will an additional reduction in staff be necessary to provide sufficient funds during fiscal years 1981 and 1982 to pay for accrued annual leave and severance pay for personnel terminated by DOE?

--If so, how would these personnel actions affect DOE's ability in the latter part of 1981 and in 1982 to be effective in resolving outstanding litigation and violations in a fair and orderly manner?

We believe OMB should assist DOE in developing a plan for the orderly resolution of the outstanding violations and litigation. Such a plan should consider and provide for DOE's personnel and funding needs to

--complete audits in process,

--continue to litigate on-going cases and use administrative and court litigation to resolve other cases when appropriate,

--continue to negotiate settlements for unresolved violations, when it is in the public interest to do so, and

--monitor companies' compliance with consent orders.

OMB should submit the plan for congressional consideration during the appropriation process and we encourage the Congress to act favorably on such a plan, assuming, of course, that it is appropriate and reasonable. The orderly resolution of DOE's alleged violations is needed to assure consistent and equitable treatment to all audited companies and to be fair to the companies that did not violate the regulations and to the companies that settled their violations with DOE. Without such actions, a bad precedent would be set for any future programs of this nature. Further, we fear that oil

companies would perceive such staffing reductions as a lack of commitment on the part of the government to bring all unresolved violations to a fair and logical conclusion and that, consequently, they would probably cease their attempts to settle with DOE.

SETTLEMENTS NEED STRENGTHENING

By January 1981 DOE had negotiated about $4 billion in settlements of alleged violations and had recovered almost $410 million, or about 10 percent, of the aggregate settlements in refunds to customers and price rollbacks. However, DOE has generally been unable to make restitution to injured parties, other than end use customers, because of its inability to identify the customers that have been overcharged or the amounts of the overcharges.

Recognizing these problems, DOE has begun to hold cash proceeds of consent orders in escrow accounts. However, DOE has yet to utilize the DOE established procedure (referred to as Subpart V) for disbursing the escrow accounts' funds, which has delayed the disposition of approximately $260 million deposited as of October 1980.

It is not clear that there are practical means to identify who has been injured by overcharges or the amounts of the injuries. If DOE cannot ascertain the victims of violations, DOE should direct the appropriate enforcement officials to petition the Office of Hearings and Appeals to implement special refund procedures to identify and make refunds to parties who have suffered injuries because of overcharges. After applying this process any remaining

refunds should be deposited in the U.S. Treasury. DOE, however, has not always followed this procedure. In at least two instances, DOE's escrow payments were distributed in a nonrestitutionary manner contrary to the limits of DOE's authority. We have already given the Committee two legal opinions on this matter.

Other settlement conditions call for the oil companies to make reductions in their banks of unrecouped costs or to make investments in such items as exploration and refinery modernization which do not provide a means for making restitution to injured parties. The bank adjustments and investment commitments accounted for $3.3 billion, or about 87 percent, of the total settlements completed by January 1981.

We are not critical per se of the policy of considering bank adjustments in settlements, because some violations resulted merely in an increase to a company's bank and not in higher prices to its customers. However, the reduction of companies' banks by about $2.3 billion did not necessarily have any effect on future prices nor represent restitution to injured parties when market conditions prevented the companies from increasing their prices even if they wanted to do so.

The $1 billion in investment commitments by the companies do not provide restitution to injured parties but it is, nevertheless, included in the aggregate amounts for DOE negotiated settlements of crude oil pricing

violations. In our opinion, DOE should separately identify and clearly distinguish their settlement provisions which provide no resitututional value, from those that provide potential remedies for overcharges, such as refunds. In this way, DOE will not obscure the restitutional value of the settlements and will not set a poor precedent for future negotiations.

The Office of Enforcement had not adopted a systematic approach to verifying compliance with consent orders. In some cases it relied solely on the word of the companies that they had complied with the settlement provisions. Office of Enforcement officals told us that a standard compliance monitoring system has now been instituted and past problems have been corrected.

To improve the settlement process and to strengthen the provisions of DOE consent orders, we are recomending that DOE:

—Allow refunds to customers only when DOE can assure itself that such refunds will result in restitution to injured parties.

—Direct the appropriate enforcement officials to petition the Office of Hearings and Appeals to implement special refund procedures to identify and make refunds to parties who have suffered because of overcharges. After applying this process, deposit any remaining escrow accounts' funds directly into the U.S. Teasury.

--Separately identify and publicly disclose restitutional and non-restitutional provisions in consent orders.

--Include in consent orders specific requirements for the documentation a company must provide DOE as evidence of compliance.

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To summarize, Mr. Chairman, DOE has made significant improvements in its audit coverage of major refiners and crude oil resellers. Oil industry legal challenges to DOE's regulations, however, have limited its ability to resolve alleged company violations. As a result, about 68 percent of the alleged violations had not been resolved as of January 1981. Even when settlements are reached, DOE has generally been unable to make restitution to injured parties.

Although petroleum pricing has been decontrolled, we believe it is critical that DOE's enforcement program remain effective so that all unresolved violations and litigation can be resolved in an orderly and fair manner. We believe that DOE and OMB should jointly develop a plan to phase out DOE's enforcement activities and that the Congress should allow DOE the funding and personnel to carry out the plan, assuming it is appropriate and reasonable.

Mr. Chairman, that concludes my prepared statement. We would be pleased to answer any questions at this time.