

DOCUMENT RESUME

00451 - [A1051991]

H.R. 2788 and Federal Energy Administration Compliance Activities. April 6, 1977. 12 pp. + enclosure (1 pp.).

Testimony before the House Committee on Interstate and Foreign Commerce: Energy and Power Subcommittee; by Monte Canfield, Jr., Director, Energy and Minerals Div.

Issue Area: Federal Procurement of Goods and Services (1900).

Contact: Energy and Minerals Div.

Budget Function: General Government: Other General Government (806).

Organization Concerned: Federal Energy Administration.

Congressional Relevance: House Committee on Interstate and Foreign Commerce: Energy and Power Subcommittee.

Authority: H.R. 2788 (95th Cong.); Federal Energy Administration Act of 1974. H.R. 2819 (95th Cong.).

House Resolution 2788 would amend the Federal Energy Administration (FEA) Act of 1974 to upgrade its contracting process to prevent conflicts of interest on the part of the contractors and establish an Office of Inspector General within FEA. Persons entering into contracts for conducting research, development, evaluation activities, or technical and management support services would be required to furnish information on possible organizational conflicts of interest. There is a need for a strong internal audit and inspection capability directly responsible to the agency head in all Federal agencies. FEA's inability to effect timely resolution of unresolved regulatory issues has remained its most significant problem. Its system of settling penalties by compromise has led to inequities due to a lack of formal guidance in penalty assessment. FEA also has problems in carrying out its compliance and enforcement program because of the small number of auditors and investigators in relation to the number of petroleum producers, refiners, wholesalers, and retailers. There should be no criminal investigation organization within FEA, though its personnel should be trained to recognize potential criminal cases.
(Author/QM)

00451

United States General Accounting Office
Washington, D.C. 20548

FOR RELEASE ON DELIVERY
Expected at 10:00 a.m. EST
Wednesday, April 6, 1977

Statement of
Monte Canfield, Jr.
Director, Energy and Minerals Division
before the
Subcommittee on Energy and Power
House Committee on Interstate and Foreign Commerce
on
H.R. 2788 and FEA Compliance Activities

Mr. Chairman, you asked that we testify today on H.R. 2788 and the operations of the Federal Energy Administration's (FEA) Office of Regulatory Programs. Let me first discuss briefly H.R. 2788 and then turn to your specific questions on FEA's regulatory activities.

H.R. 2788 would amend the Federal Energy Administration Act of 1974 to (1) upgrade its contracting process to prevent conflicts-of-interest on the part of contractors, and (2) establish an Office of Inspector General within FEA.

Regarding organizational conflicts-of-interest, the bill would require persons entering into contracts for conducting research, development, evaluation activities, or for technical and management support services, to furnish the FEA Administrator information concerning possible organizational conflicts-of-interest. This provision would apply to subcontractors as well, except for supply subcontracts (in any amount) or

any other subcontracts of \$10,000 or less. This proposal seems to be consistent with the intended purpose of avoiding conflict-of-interest to the maximum extent practicable without unreasonable delay of the procurement process. We believe its enactment would serve a useful purpose.

As to the establishment of an Office of Inspector General in FEA, our Office is currently preparing formal comments on H.R. 2819--a bill to establish an Office of Inspector General within 11 separate Federal departments and agencies. Although FEA is not one of the 11 agencies, the provisions in H.R. 2788 are very similar to those in H.R. 2819. Therefore, our detailed comments on H.R. 2819 would apply to the provisions in H.R. 2788 as well. We will provide our formal comments on H.R. 2819 to the Subcommittee when they are finalized.

I might say that the GAO does support the need for a strong internal audit and inspection capability in Federal agencies. We do have concern with provisions of H.R. 2788 which appear, in some areas, to remove the Inspector General from meaningful direction and supervision by the FEA Administrator. The agency head bears ultimate responsibility for agency programs and, in our opinion, needs a strong audit capability which is directly responsible to him and independent of program activity.

Let me turn to FEA's regulatory and compliance activities and discuss that in the context of (1) our prior work in the area, (2) the three specific questions asked by the Chairman

of this Subcommittee in his request for our testimony, and (3) our comments and views on the seven recommendations contained in the February 28, 1977, Subcommittee staff report on FEA's compliance program.

FEA'S COMPLIANCE PROGRAM

Our first major report on regulatory and compliance activities was issued in July 1974. During the period July 1974 to October 1975--the date of the last major report issued by us dealing with regulatory and compliance activities --we issued a number of reports which addressed both the successes and failures of FEA's regulatory programs. We have testified on these areas before several committees of the Congress. Attached to my statement is a listing of these reports and statements.

In its early years, FEA was faced with the difficult task of developing and implementing regulations for a large and diverse industry during a period when the national interest called for a quick reaction to the "energy crisis." The initial regulations contained gaps and ambiguities which required numerous revisions and interpretations. These ambiguities and the resulting need for regulatory interpretations have resulted in unresolved issues which have hampered the regulatory and compliance process.

In our May 1975 testimony before the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce, we pointed out that there were numerous

unresolved regulatory issues. There still remain many unresolved regulatory issues--a circumstance which continues to hamper the effectiveness of FEA's compliance effort.

In preparing for this hearing, we obtained information from FEA officials which shows that there currently are 30 unresolved issues which involve at least 202 identified cases. Examples of unresolved issues include (1) the class of purchaser issue which requires definition of certain types of business relationships and (2) the issue of proper determination of the base level control period for purposes of calculating subsequent allowable price increases. These issues were unresolved at the time of our May 1975 testimony and remain unresolved today.

FEA has taken steps to improve its compliance regulations. Included in these have been Decisions and Orders, Exception and Appeals actions, and Rulemakings which have addressed some of the gaps and, in some cases, established new regulatory procedures. In addition, the energy legislation passed over the years has addressed some of the ambiguities in FEA's regulations. For example, the Energy Conservation and Production Act passed in August 1976, limited FEA's authority to enforce its regulations on a retroactive basis.

The foregoing provides some perspective on the current environment in which FEA's Office of Regulatory Programs functions. This environment is complicated by differences

between industry reporting required by FEA to meet its regulatory needs and the manner in which industry normally records its activities for financial and management purposes. The process that industry must follow to restructure its internal data into FEA's reporting formats involves numerous allocations, reclassifications, and estimates. After-the-fact verifications by FEA of the restructured data often is time consuming and difficult and frequently hampered by the lack of complete documentation of the steps used by industry in restructuring the data.

Given this perspective, let us comment on the three areas where you raised specific questions. Generally, you asked for our views on

- FEA's criteria for national office review of compliance actions,
- FEA's authority to assess civil penalties administratively and to compromise such penalties, and
- the appropriateness of FEA's strategy for auditing petroleum industry compliance with regulations.

SPECIFIC QUESTIONS ON FEA'S COMPLIANCE ACTIVITIES

Criteria for national office involvement in compliance actions

The widespread applicability of FEA's regulations requires close control over compliance and enforcement actions to assure uniformity of application. The existence of unresolved regulatory issues provides the potential for differing

interpretations. In the past, there has been inconsistent application of FEA's enforcement authority due to the lack of centralized control. Establishing dollar amounts--threshold values--under which cases in excess of these amounts would be reviewed by the national office could help to centralize decisionmaking on important issues. FEA has established threshold values of \$1 million for notices of probable violation and \$500,000 for remedial orders.

Our past reviews of FEA's compliance activities lead us to believe that the threshold values should bring most, if not all, significant issues to the attention of the national office. While we cannot say that all cases meeting the threshold criteria require national office attention, we believe that the establishment of threshold values is a step in the right direction.

We believe now, as we did in the past, that FEA's inability to effect timely resolution of unresolved regulatory issues is the most significant problem. FEA is well aware of this situation but, as indicated by the continued existence of a large number of these issues, has been unable to correct it.

On February 14, 1977, the agency implemented a priority system designed to resolve open cases in order of their significance. The system classifies cases, depending on their importance, in one of four categories.

--Category A involves top priority cases in which there is a likelihood of a criminal violation.

- Category B involves cases which are one year old and have an identified potential violation in excess of \$150,000. These cases are considered of special interest to congressional committees and require extensive inter-regional work.
- Category C involves cases requiring normal audit work and if necessary, may be conducted on an intermittent basis. Audit time is programmed for these cases to ensure that they progress essentially on schedule.
- Category D involves cases where audit work has been suspended because of lack of resources, higher priority work, a pending regulatory decision, or a pending exception and appeal action.

Conceptually, the system appears sound from the standpoint of auditors assigning priorities to their work. However, it is not designed to expedite resolution of previously mentioned outstanding regulatory issues.

Assessing and compromising penalties

FEA takes the position that it lacks authority to "assess and impose" civil penalties by administrative order. The agency concludes that only a Federal district court can impose civil penalties on an unwilling party on the basis of a lawsuit prosecuted by the Department of Justice.

FEA does, however, follow an administrative process by which it identifies potential civil penalty cases and determines

through a series of predictive factors the amount of the penalty it would expect a court to assess if the case were prosecuted. FEA settles penalties by a system of compromise whereby the agency accepts less than the statutory maximum for penalties to avoid resorting to full-scale judicial procedures.

In response to your specific questions, Mr. Chairman, our Office of General Counsel is looking at the legal issues related to assessing and compromising penalties. We will provide our detailed answers as soon as possible. Meanwhile, I can offer some comments on FEA's compromise system.

In our June 1975 testimony before the Subcommittee on Administrative Practice and Procedure of the Senate Judiciary Committee, and in our October 1975 report on FEA's efforts to audit domestic crude oil producers, we pointed out the lack of formal guidance to the FEA regional offices regarding the circumstances under which penalties should be sought and assessed. As a result, violators, because of the geographic location, were not being treated equitably.

While we have not made a detailed review of FEA's procedures since that time, we have seen nothing that has led us to believe that the problems have changed.

As of February 1977, on overcharges of about \$500 million, FEA had accepted compromises of about \$3.5 million--less than

1 percent of the overcharges. Also, there still appear to be questions of equity in assessing penalties. For instance, major refiners have compromised penalties at slightly over \$900,000 on \$355 million in overcharges--less than 0.3 percent. On the other hand, on \$19 million in overcharges, independent crude oil producers have paid \$723,000 in compromises--about 3.8 percent.

Audit strategies

FEA is faced with a difficult task of insuring compliance with price regulations involving all elements of a complex industry. In our May 1975 testimony, we pointed out that there were about

--19,000 crude oil producers,

--200 oil companies with a total of about 250 refineries,
and

--25,000 wholesalers.

While we have not updated these figures, it is reasonable to assume that the numbers have not changed significantly.

FEA's compliance and enforcement program has historically been restrained by the limited number of auditors and investigators available. As of February 1977 there were 1,068 compliance and enforcement personnel in FEA's 10 regional offices. These auditors and investigators are responsible for the review of

-- Importers,

-- Crude oil resellers,

- Independent crude oil producers,
- Major refiners,
- Small refiners,
- Natural gas liquid processors,
- Propane resellers,
- Propane retailers,
- Other resellers, and
- Other retailers.

This responsibility is quite substantial and FEA has historically been unable to effectively audit their operations. In the area of refiners alone, without success FEA has tried several different audit strategies.

In May 1975 there were 161 auditors assigned to the refinery program. As of February 1977, there were 266 auditors assigned. To date FEA has not completely verified the accuracy of the May 1973 base period data--against which all subsequent cost increases and prices are measured.

At the request of the Chairman of the Subcommittee on Government Regulation, Senate Select Committee on Small Business, we are now reviewing the compliance activities in FEA's Boston region. We are also reviewing FEA's administration of regulations concerning the transportation cost of importing foreign crude oil at the request of the Chairman of the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce. Preliminary results of our ongoing work indicate that FEA continues to have

problems in carrying out its compliance and enforcement program.

Some of the problems are caused by the unresolved regulatory issues and inappropriate regulatory reporting requirements discussed earlier. Other factors, which our previous work has shown, and which may have contributed to the existing situation, are the number of special programs such as the propane and fuel oil supplier audits which took auditors away from other review programs, inter-regional disputes over jurisdiction and support roles, attrition of personnel, and uncertainties over the future of the regulatory program. The Subcommittee staff's efforts indicate that in differing degrees these factors still exist and continue to hamper FEA's abilities to meet its audit goals.

FEA's August 1975 proposal for annual audits of firms doing 80 percent of the volume of business in a given program; audits every 3 years for firms doing 15 percent of the business; and 5-year audits for the remaining 5 percent was, in our view, overambitious in the light of FEA's past experience. Whether it could be accomplished with the 2,400 personnel originally requested is questionable. The fiscal year 1977 strategy, whereby a staff of 1,396 would perform annual audits of major refiners, biennial audits for firms in other programs doing 80 percent of the business, and 5-year audits for the remaining 20 percent, is also questionable.

As stated above, the fiscal year 1977 strategy calls for a staffing level of 1,396. The fiscal year 1978 plan reduces this to 1,221. Whether either staffing level is sufficient to successfully carry out the audit strategy is questionable.

SUBCOMMITTEE RECOMMENDATIONS

I believe our testimony today has addressed most of the areas covered in the seven recommendations made by the Subcommittee staff. They generally are consistent with the recommendations and views expressed in our previous reports and testimony, and we generally endorse them. There is one recommendation, however, that concerns us.

We do not favor a criminal investigation organization within FEA. This is the responsibility of the Department of Justice. In our view cases involving suspected criminal activity should be referred to the Department of Justice for resolution. Certainly, there should be training programs which would give FEA auditing and investigative personnel the ability to recognize potential criminal cases. As needed, FEA should provide the Department of Justice with technical assistance in following through on such cases.

Mr. Chairman, this concludes my formal statement. We will be glad to answer any questions.

MAJOR COMPLIANCE REPORTS ISSUED

<u>DATE</u>	<u>TITLE</u>
July 23, 1974	Problems in the Federal Energy Office's Implementation of Emergency Petroleum Allocation Programs at Regional and State Levels (B-178205)
Dec. 6, 1974	Problems in the Federal Energy Administration's Compliance and Enforcement Effort (B-178205)
July 15, 1975	Federal Energy Administration's Efforts to Audit Fuel Oil Suppliers of Major Utility Companies (OSP-76-2)
Oct. 2, 1975	Federal Energy Administration's Efforts to Audit Domestic Crude Oil Producers (OSP-76-4)

TESTIMONY ON FEA COMPLIANCE ACTIVITIES

<u>DATE</u>	<u>SUBJECT</u>
Dec. 11, 1974	Statement of Phillip S. Hughes, Assistant Comptroller General of the United States on FEA's Compliance and Enforcement Activities before the Subcommittee on Reorganization, Research, and International Organization, Senate Committee on Government Operations
May 8, 1975	Statement of Phillip S. Hughes, Assistant Comptroller General of the United States on FEA's Compliance and Enforcement Activities before the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce
June 19, 1975	Statement of Phillip S. Hughes, Assistant Comptroller General of the United States on the FEA's Compliance and Enforcement Processes before the Subcommittee on Administrative Practice and Procedure; Senate Committee on the Judiciary