COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-207463

February 19, 1986

The Honorable Edward J. Markey
Chairman, Subcommittee on Energy
Conservation and Power
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

DO NOT MAKE AVAILABLE TO PUBLIC READING

By letter of February 6, 1986, you requested that GAO provide a legal opinion on the consistency of the Department of Energy's (Energy) proposed revised uranium enrichment services criteria with the requirements of law. These proposed criteria are set forth at 51 Federal Register 3624 (January 29, 1986). You also requested that we provide this opinion in time for your hearings scheduled for February 19, 1986. We have here set forth the major issues of legal concern, but in light of the time constraint, we did not solicit Energy's views.

In summary, we have concluded that Energy's proposed revised uranium enrichment services criteria are contrary to some basic and significant elements of the letter and legislative history of the statute governing the substantive requirements of the uranium enrichment program. Therefore, despite recognizing that economic circumstances of the enrichment market have changed and whatever the policy merits of Energy's proposal, it cannot legally be accomplished through rulemaking. We recommend that the policy changes reflected in Energy's proposed revised criteria be introduced in the form of a bill in the Congress and formally enacted before any further attempt is made to implement them.

More specifically, the primary substantive requirements of Energy's uranium enrichment program are set forth in subsection 161(v) of the Atomic Energy Act of 1954, as amended, 42 U.S.C. § 2201(v). That provision prescribes, in relevant part, that:

1. "any prices established under this subsection shall be on a basis of recovery of the Government's costs over a reasonable period of time";

2. prices for services provided "shall be established on a nondiscriminatory basis";

3. Energy, "to the extent necessary to assure the maintenance of a viable domestic uranium industry, shall not offer such services for source or special nuclear materials of foreign origin intended for use in a utilization facility within or under the jurisdiction of the United States";

4. Energy "shall establish criteria in writing setting forth the terms and conditions under which services provided under this subsection shall be made available"; and

5. before Energy establishes such criteria, the proposed criteria shall be submitted to the appropriate authorizing committees of the Congress, and a period of 45 days shall elapse while Congress is in session.

In addition, the reports of the Joint Committee on Atomic Energy accompanying the enacted subsection 161(v) set forth the Joint committee's view on the terms and conditions that should be included in the criteria: "Included among these 'terms and conditions' would be such matters as the charges for enrichment services, the conditions under which such services would be offered, and the general features of standard contracts for uranium enrichment services." H.R. Rep. No. 1702, 88th Cong., 2d Sess. 16 (1964); S. Rep. No. 1325, 88th Cong., 2d Sess. 16 (1964).

The proposed revised uranium enrichment services criteria and accompanying Supplementary Information are not consistent with the statute or the Joint Committee's advice in the following major respects:

1. The criteria provide that henceforth Energy's primary pricing objective of the enrichment program is maintenance of Energy's long-term competitive position,

   a. relegating to a secondary objective the statutory requirement that the Government's costs be recovered over a reasonable period of time;

   b. rejecting the concept of full cost recovery of the Government's investment, which had been implemented in practice for more than 15 years and had been endorsed by the Congress, Energy and its predecessor agencies, and GAO;

   c. explicitly stating that Energy will not recover from customers in excess of $4 billion of prior Government investments in the program; and

   d. asserting that the new standard for cost recovery is only "appropriate" Government costs, which Energy states will

only be those actually incurred in providing enrichment services to current civilian customers.

2. The criteria provide that prices will be individually negotiated, and they fail to set forth any fixed price or pricing mechanism, contrary to the Joint Committee's directive that "the charges for enrichment services" are to be set forth in the criteria.

3. The criteria fail to make provision for any standard contracts or to set forth the material general features to be contained in contracts, contrary to the Joint Committee's directive that the "general features of standard contracts for uranium enrichment services" are to be set forth in the criteria.

In addition, we have reservations about (1) whether the statutory requirement for assurance of nondiscrimination can be satisfied in practice if the proposed criteria are implemented as reflected in the Supplementary Information accompanying them, and (2) whether Energy has satisfied the statutory requirement regarding enrichment of uranium of foreign origin. This latter issue is currently being litigated before the U.S. District Court in Colorado.

COSTING

The proposed revised uranium enrichment services criteria are premised on the basis that the recovery of the Government's full costs of providing enrichment services is not required, and that "Congress granted [Energy] considerable discretion to determine, in the first instance, the best pricing approach and which costs are appropriate for recovery in an ever changing environment." 51 Fed. Reg. 3226 (January 29, 1986). We believe Energy is in legal error on this matter.

As you know, at the request of your subcommittee, we rendered a legal opinion (B-207463, December 27, 1984) in which we concluded that full cost recovery, including depreciation, was statutorily required after the 1970 amendment to subsection 161(v) of the Atomic Energy Act of 1954, 42 U.S.C.

§ 2201(v).[1] A copy of this opinion is enclosed for your convenience.

Footnote 5 to the Supplementary Information accompanying Energy's proposed criteria revisions specifically rejects this full cost recovery standard. In so doing, Energy relies extensively on the flexibility referred to in the 1964 legislative history when the Private Ownership of Special Nuclear Materials Act[2] was passed, adding subsection 161(v) to the Atomic Energy Act. The pricing standard provided in that act was admittedly the flexible one of "reasonable compensation to the Government." However, subsection 161(v) was amended in 1970[3] specifically to change the pricing standard to one of "recovery of the Government's costs over a reasonable period of time." It is the legislative history associated with the 1970 amendment that is now relevant and not that of the predecessor version of the statute.

As pages 6 and 7 of Appendix III to our December 27, 1984 legal opinion more fully explain, in the reports[4] of the Joint Committee on Atomic Energy associated with the 1970 amendment, the Joint Committee explicitly affirmed a GAO legal interpretation[5] of the meaning of subsection 161(v) as the Committee's intended meaning of the new statutory language

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1/ As is more fully explained in that opinion, there was one exception specifically provided for in the legislative history of the 1970 amendment; namely, where the Conway Excess Capacity Formula was applicable. However, this exception is no longer relevant, because the interim period in which the Conway Formula applied expired in 1976 when Energy exceeded 75 percent of production capacity from its gaseous diffusion plants.

2/ Public Law No. 88-489, approved August 26, 1964, 78 Stat. 603.

3/ Section 8 of Public Law No. 91-560, approved December 19, 1970, 84 Stat. 1472, 1474.

4/ H.R. Rep. No. 1470, 91st Cong., 2d Sess. 2 (1970); S. Rep. No. 1247, 91st Cong., 2d Sess. 2 (1970).

5/ B-159687, July 17, 1970 entitled Review of Proposed Revisions to the Price and Criteria for Uranium Enrichment Services, at 9, reprinted in Uranium Enrichment Pricing Criteria, 91st Cong., 2d Sess. 161-238 (June 16 and 17, 1970).

requiring "recovery of the Government's costs over a reasonable period of time." GAO's opinion required the recovery of costs in every instance except one, namely, the situation for which the Conway Formula had been devised to deal with the reduction or possible elimination of the military need for enriched uranium. Flexibility and consideration of the national interest were directed specifically and solely to this particular problem. As is explained in footnote 1 to this opinion, the interim period for which the Conway Formula applied expired in 1976 and is no longer relevant. Consequently, under the 1970 amendment to subsection 161(v) and its legislative history, full cost recovery is required.

GAO continues to believe that under existing statutory constraints, Energy does not have the legal flexibility to exclude unilaterally any government costs from its prices given the full cost recovery pricing requirement. The general tenor and a number of specific provisions of the proposed criteria contravene this legal requirement. For example, proposed 10 C.F.R. § 762.5 provides for recovery of only "appropriate" Government costs, with an implicit right reserved to Energy to determine what costs are appropriate. In this connection, Energy states in the Supplementary Information accompanying the proposed criteria revisions that:

> "The costs of items which are not, and most likely will not, be used in providing enrichment services to current civilian customers are not appropriate for consideration in determining the extent to which Government's costs are recovered over a reasonable period of time. [Energy] has determined that none of the costs of the Gas Centrifuge Plants and only forty percent of the costs of the Gaseous Diffusion Plants are used to provide enrichment services to civilian customers. Accordingly, only these latter costs are appropriate for determining the extent to which the Government's costs are recovered over a reasonable period of time."

51 Fed. Reg. 3628 and 3629 (January 29, 1986).

Our December 27, 1984, opinion addressed the legality of the exclusion from cost recovery and prices of the $1.2 billion of undepreciated value attributable to unused capacity of the gaseous diffusion plants. We held that this write-off for pricing purposes of undepreciated plant and capital equipment, so as to obviate the need for customer payments of related depreciation and imputed interest as part of the fee for

enriching services, violates the cost recovery requirement of subsection 161(v) of the Atomic Energy Act of 1954, as amended, 42 U.S.C. § 2201(v). We have an open request from this subcommittee for a legal opinion on Energy's exclusion from current and future prices of its investment in the Gas Centrifuge Enrichment Plant (GCEP). We have formally requested of Energy any basis for its actions which would differentiate GCEP from our conclusions regarding the unused plant capacity of the gaseous diffusion plants. We have received no response from Energy, and we are aware of no distinguishing factors which would justify a different GAO result on the exclusion of GCEP costs from Energy's pricing formula.

These so-called write-offs result in a shifting of more than $4 billion of program costs from enrichment customers to the Government. This in effect constitutes a subsidization of the enrichment program in contravention of the Atomic Energy Act of 1954, as amended, and its legislative history. See Uranium Enrichment Service Criteria and Related Matters, Hearings Before the Joint Committee on Atomic Energy, 89th Cong., 2d Sess. 29, 33, 121, 319, 517 and 518 (August 2, 3, 4, 16 and 17, 1966).

We held in our December 27, 1984 legal opinion and still find that in order for enrichment program assets to be legally written-off and not recovered in the service price from customers, Congress must amend the Atomic Energy Act to authorize it. A criteria change will not suffice, since the criteria must be in accord with the statute.

PRICING

Proposed 10 C.F.R. § 762.4 provides:

"[Energy] shall negotiate prices in individual enrichment service contracts in accordance with an overall approach intended to maintain the long-term competitive position of [Energy] while obtaining the recovery of the Government's costs over a reasonable period of time."

51 Fed. Reg. 3631 (January 29, 1986). In addition, in the Supplementary Information accompanying the proposed revised criteria, Energy states that this "approach will permit [Energy] to pursue a vigorous program to regain market share." 51 Fed. Reg. 3628 (January 29, 1986). Elsewhere in that statement, Energy asserts that the Atomic Energy Act "does not mandate any particular form of pricing. Rather, it grants [Energy] considerable flexibility to determine what prices best achieve the objectives of [Atomic Energy Act], including

recovery of the Government's costs over a reasonable period of time." Id.

Whatever the policy merits of this proposed pricing approach of Energy, it is inconsistent with the Atomic Energy Act and its legislative history governing the substantive requirements of the uranium enrichment program.

Subsection 161(v) of the Atomic Energy Act of 1954, as amended, 42 U.S.C. § 2201(v), provides that "any prices established under this subsection shall be on a basis of recovery of the Government's costs over a reasonable period of time." Moreover, the reports of the Joint Committee on Atomic Energy accompanying enactment of subsection 161(v) directed that "the charges for enrichment services" be set forth in the criteria. H.R. Rep. No. 1702, 88th Cong., 2d Sess. 16 (1964); S. Rep. No. 1325, 88th Cong., 2d Sess. 16 (1964).

Energy's proposed pricing approach chooses as primary pricing objectives of the program principles which are not referred to in the Atomic Energy Act or its legislative history--namely, the maintenance of Energy's long-term competitive position and pursuing a vigorous program to regain market share. On the other hand, it relegates to a secondary objective the primary statutory pricing requirement of obtaining the recovery of the Government's costs over a reasonable period of time. Moreover, the charges for enrichment services are not set forth in the proposed criteria as directed by the Joint Committee.6/ Rather, there is to be no fixed price or pricing mechanism. 51 Fed. Reg. 3628 (January 29, 1986). Energy plans to negotiate prices in individual enrichment services contracts.

Energy's new pricing approach has no particular sanction in present law nor was it contemplated by the committees considering the legislation. Accordingly, whatever its policy merits, in our view, it should not be accomplished through rulemaking. This major reorientation of pricing policy and

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6/ We recognize that current enrichment service criteria also do not specify a particular price for enrichment services. See 44 Fed. Reg. 28875, 28876 (May 17, 1979). However, they provide for a pricing mechanism. They specify the costing elements to be included in the price, and were based on full recovery of the Government's costs and the prohibition on the making of a profit. Accordingly, the service charge or price was whatever was required to recover the listed costs over a reasonable period of time.

practice should only be legally accomplished by amendment of the Atomic Energy Act's pricing provisions.

OTHER TERMS

Subsection 161(v) of the Atomic Energy Act of 1954, as amended, 42 U.S.C. § 2201(v), provides that Energy "should establish criteria in writing setting forth the terms and conditions under which [uranium enrichment] services provided under this subsection shall be made available." In addition, the reports of the Joint Committee on Atomic Energy accompanying the enacted subsection 161(v) state:

> "Included among these 'terms and conditions' would be such matters as the charges for enrichment services, the conditions under which such services would be offered, and the general features of standard contracts for uranium enrichment services." (Emphasis added.)

H.R. Rep. No. 1702, 88th Cong., 2d Sess. 16 (1964); S. Rep. No. 1325, 88th Cong., 2d Sess. 16 (1964).

In implementation of these requirements, the 1966 criteria specified two standard types of contracts--Firm Quantities Contracts and Requirements Contracts. The basic principles of each type were set forth along with the more significant provisions of the contracts. See 31 Fed. Reg. 16479 (December 23, 1966). Similarly, the criteria adopted in 1973 and, in large part, still effective today identified the Fixed Commitment Contract as its primary contracting vehicle and specifically set forth some new basic principles and concepts to be employed in the contracts. 38 Fed. Reg. 12180, 12181 (May 9, 1973) and 44 Fed. Reg. 28875 (May 17, 1979).

Moreover, current criteria include many guidelines on contract features in general terms, which must or may be included in Energy's uranium enrichment contracts in detail. Examples are provisions concerning advance contracting, fixed commitments, advance payments, delivery schedules, chemical form and specifications of feed material, the basis on which charges for enriching services will be calculated, the basis on which charges for termination by the customer will be calculated, delivery, transfer of title, and others.

Under Energy's proposed revised criteria, this practice will no longer be continued. Energy will have no standard contracts. Moreover, the proposed criteria contain virtually no significant general features to be contained in contracts.

Prices are to be individually negotiated, as are termination charges and other contractual provisions. In addition, Energy explicitly states that "a contract can contain terms and conditions not specified in the criteria. No prohibition against a term or condition is intended by its non-inclusion in the proposed criteria." 51 Fed. Reg. 3629 (January 29, 1986). The only restriction is that "the terms and conditions in a contract cannot be inconsistent with the criteria." See proposed 10 C.F.R. § 762.14.

The purpose of the statutory requirement that the terms and conditions under which enrichment services will be provided be established in published criteria and the directive of the Joint Committee on Atomic Energy that the charges for services and general features of standard contracts be set forth in the criteria was to enable the exercise of some congressional control over the content of uranium enrichment contracts and enrichment prices prior to their becoming effective, as well as facilitating congressional oversight. Energy's proposed revised criteria severely limit all of these objectives. When Energy's predecessor (the Atomic Energy Commission) proposed very general criteria in 1973 excluding some of these elements, they were rejected by the Joint Committee on Atomic Energy. Several examples of statements made by committee members at that time are illustrative of their reaction:

1. "Senator Jackson. * * * the revised criteria omit any reference to the types and significant details of the contracts under which enrichment services will be provided." Proposed Changes in AEC Contract Arrangements for Uranium Enriching Services, Hearings Before the Subcommittee on Energy, Joint Committee on Atomic Energy, 93rd Cong., 1st Sess. 2 (March 7, 8, 26; and April 18, 1973).

2. "Representative Price. Since the significant features of the new types of contracts are not described in the criteria there appears to be nothing that would require the Commission to return to the Joint Committee should it decide to vary the terms and conditions under which it would provide the uranium enrichment services. This seems to be a substantial departure from the intent of section 161(v) * * *." Id., at 32.

3. "Representative Holifield. * * * What control do you feel the Joint Committee will have over the essential terms and conditions of this or any other contract for enriching services under the new criteria?

"Mr. Allen [President, Yankee Atomic Electric Co., and Vice President, New England Electric System]. None.

"Representative Holifield. Thank you. I came to the same conclusion. * * * The new criteria would eliminate any supervision of this committee over these things." Id., at 83.

We believe that the failure of Energy's proposed revised criteria to provide for standard contracts and to set forth their material general features is contrary to the intended structure and operation of the uranium enrichment program as reflected in the Atomic Energy Act and its legislative history.

NONDISCRIMINATION

Subsection 161(v) of the Atomic Energy Act of 1954, as amended, 42 U.S.C. § 2201(v), requires that prices for enrichment services "shall be established on a nondiscriminatory basis." Proposed 10 C.F.R. § 762.7 provides:

> "The same prices, as well as other terms and conditions, shall be available to all similarly-situated customers on a nondiscriminatory basis, reflecting the cost of the enrichment services supplied to those customers."

Although the language of this proposed nondiscrimination criterion refers to the statutory language, we have reservations whether the statutory standard can be satisfied in practice if the proposed criterion is implemented as reflected in Energy's Supplementary Information and the other proposed criteria.

Energy's proposed revised criteria provide that it will negotiate price, as well as other terms and conditions of a contract. Not only will there be no fixed price, but no fixed price mechanism. There will be no standard contracts. Similarly, there need not be standardized terms and conditions for other aspects of a contract. Despite these circumstances, Energy states in the Supplementary Information accompanying the

proposed criteria provisions that the statutory nondiscrimination provision means that "all customers * * * be afforded an opportunity to strike a bargain equal in attractiveness to those available to other customers." 51 Fed. Reg. 3629 (January 29, 1986). However, no provision is made in the criteria for disclosure of pricing and other contracting information to other customers when a particular contract is entered into.

In these circumstances, we have reservations whether the proposed criterion provision will assure in implementation the nondiscriminatory treatment required by the statute. This is a very different factual situation from that existing previously, when there were standard contracts, general features contained in these contracts, and a published price for services available to all customers.

CONCLUSION

For the above reasons, we have concluded that Energy's proposed revised uranium enrichment services criteria are contrary to the letter and legislative history of the statute governing the substantive requirements of the uranium enrichment program. Consequently, they cannot be legally accomplished through rulemaking, whatever their policy merits. We recommend that, if Energy wishes to continue to pursue the policy initiatives reflected in these proposed criteria revisions, these policy changes be introduced in the form of a bill in Congress and formally enacted before any further attempt is made to implement them.

Notwithstanding these conclusions, it must be recognized that the current market situation with regard to the sale of uranuim enrichment services is far different from conditions which prevailed at the time the full cost recovery requirement was enacted. As we have stated on a number of occasions in the past, there is a compelling need, because of the market changes and constraints imposed by full cost recovery pricing in the current market environment, for the executive branch and the Congress together to reexamine the fundamental purpose and structure of the uranium enrichment program.

Sincerely yours,

Milton J. Socolar

Acting Comptroller General
of the United States

Enclosure