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Paul L. Bloom

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ENFORCEMENTS PROCEDURES FOR PRICE REGULATION AUDITS AND OVERCHARGES

Paul L. Bloom*

The original concept of a Special Counsel for Compliance for the Department of Energy (DDE) was suggested by the Task Force on Compliance and Enforcement,¹ created by John O'Leary, Administrator of the former Federal Energy Administration (FEA). When Mr. O'Leary assumed office last winter, he found the compliance effort of the FEA floundering and suffering from longstanding criticism; criticism similar to that mentioned here today that there had been diffused, poorly coordinated efforts to enforce a very ambitious scheme of price and allocation regulations² covering the extremely complex petroleum industry.³

* Special Counsel for Compliance, Department of Energy, Washington, D.C.; B.A., University of Chicago, 1960; LL.B., University of New Mexico School of Law, 1965.

1. In May, 1977, the Federal Energy Administration (FEA) created the Task Force on Compliance and Enforcement. Stanley Sporkin, director of enforcement for the Securities Exchange Commission, headed the 14-member group whose task was to review all aspects of FEA's compliance program concerning petroleum price and allocation controls. [1977] 197 EN. USERS REP. (BNA), at 13. The Sporkin Task Force Report is summarized in [1978] 207 EN. USERS REP. (BNA) 13.

2. Statutory authority for pricing and allocation controls on the American petroleum industry appears in the Emergency Petroleum Allocation Act of 1973, Pub. L. No. 93-159, 87 Stat. 627 (to be codified in 15 U.S.C. §§ 751-60), *amending* the Energy Policy and Conservation Act of 1975, Pub. L. No. 94-163, 89 Stat. 941-55 (to be codified in 15 U.S.C. §§ 753-55, 757-60h), and the Energy Conservation and Production Act of 1976, Pub. L. No. 94-385, 90 Stat. 1132-33 (to be codified in 15 U.S.C. § 757). Pursuant to this authority, FEA promulgated Mandatory Petroleum Allocation Regulations, 10 C.F.R. 211 (1974) and Mandatory Petroleum Price Regulations, 10 C.F.R. 212 (1974). FEA and now DOE have modified the regulations several times.

3. DOE recently supplied the following projected figures relating to energy supply and cost:

An increase in reserves of 45.8 billion barrels in 1978-85; development and exploration expenses of \$150 billion over that period; an average cost of \$3.30 per barrel of reserves; \$170 billion in industry cash flow 1978-85 (ex dividend requirements) with finding cost estimates based on the Joint Association Survey [put together annually by American Petroleum Institute, Independent Petroleum Association of America, and Mid-Continent Oil & Gas Association] and the rate of reserve additions based on U. S. Geological

This scheme of regulations was developed literally during emergency conditions⁴, and while it was constructed in good faith, the framers of this regulatory program were unable to enjoy optimal conditions where they could objectively and cautiously construct a complex regulatory package of importance and significance to the United States. The program had a clear statutory mandate to enforce these ambitious regulations. The agency elected a system of price regulation that established a base price⁵ and then imposed a monitored cost pass-through system⁶ in addition to that base price. In fact, this system proved to be much easier to put in place than to monitor and administer. Because of its complexity, many disputes and uncertainties over the meaning of definitions and other operative terms developed. I would be the first to concede that the predecessors of the Department of Energy's compliance activity were not always as quick and as clear as they might have been in getting those terms interpreted⁷ and clarified quickly. That does not mean that we have unenforceable regulations, or that the Department has not lawfully interpreted and clarified some of those same provisions later in the course of regulation. I would also say in defense of the program that, it was coping with an exceptional emergency during the embargo⁸ and trying to balance contradictory policy imperatives such as protection of consumers and protection of the incentive to produce, while at the same time attempting to maintain an orderly marketplace. In addition, this rather extraordinary and complex program had to be administered by an agency set up as a tempo-

Survey data . . . that average revenues (per barrel oil equivalent) would be \$7.01 in 1978, \$9.31 in 1985, up 4.1% a year, and average net income per barrel would be \$1.64 per barrel oil equivalent in 1978, rising to \$2.68 in 1985, and that production in equivalent oil would be 6.7 billion barrels in 1978, the same in 1985.

[1978] 207 CAPITAL ENERGY LETTER 6.

4. The Emergency Petroleum Allocation Act, Pub. L. No. 93-159, 87 Stat. 627 (to be codified in 15 U.S.C. §§ 751-60), was enacted on November 27, 1973. "The Federal Energy Office (FEO) was established on December 4, 1973 pursuant to the EPAA and issued its initial Mandatory Petroleum Allocation and Price Regulations effective January 14, 1974." U.S. Senate, *Committee on Energy and Natural Resources*, "Regulation of Domestic Crude Oil Prices," 6 PUBLICATION 95-8 (March, 1977) [hereinafter cited as *Domestic Crude Oil Prices*].

5. The base price was the May 15, 1973 posted price which represented a time of relative stability in the crude oil market. *See id.* at 5.

6. 10 C.F.R. 212.83(c) covers the time and manner in which refiners can pass through increased product and nonproduct costs to the consumer. These regulations received the description "remarkably inept and self-contradictory" by a federal district court judge in Ohio recently when he permanently enjoined the Department of Energy from forcing nine major oil companies to return up to \$1.3 billion in alleged overcharges to consumers. *Standard Oil Company v. Federal Energy Administration*, No. C-76-1279, Northern District, Eastern Division, January 20, 1978 [1978] 233 EN. USERS REP. (BNA) 14.

7. 10 C.F.R. 205.80 deals with interpretations.

8. *See generally Domestic Crude Oil Prices*, *supra* note 4.

rary emergency agency, which therefore had difficulty in obtaining a permanent, highly qualified staff.

By the winter of 1977, the compliance program consisted of approximately one thousand auditors and supervisors and a small number of lawyers from the General Counsel's office all trying to do the virtually impossible job of systematically reviewing all regulated companies which had at any time been covered by these regulations since 1973. Originally the program had included regulation of the industry from domestic crude production to the corner gas station. Some elements of the industry have subsequently been removed from regulation,⁹ somewhat simplifying the current monitoring function of the agency.

The net result was that in the winter of 1977, Mr. O'Leary found a bitterly criticized and certainly unsatisfactory enforcement program, and he established a task force to analyze the program and its problems. He took the unusual step of inviting a man of recognized independence of judgement, Stanley Sporkin, to head this task force. Mr. Sporkin was supported by a couple of senior people he brought over from the Security Exchange Commission (SEC), where as head of enforcement he had built up a very impressive reputation as a firm enforcer of a complex regulatory system. He was also supported by a number of FEA people, including myself. I was at that time Deputy General Counsel for Compliance and Litigation. In a sixty-day period this task force accomplished its objective of submitting a written report on the state of the compliance program.¹⁰ There were some very bad things said about the compliance program along with a flagship recommendation that there be appointed a Special Counsel. The theory was that the Special Counsel of the DOE should segregate the thirty-four largest refiners which had previously been the target of the Refiner Audit Review Program, and that this compliance effort be given exceptionally high priority in resources of the Department. One of the sad commentaries on the historical compliance effort was that, while FEA had audit teams at the thirty-four refineries for a couple of years, they

9. Crude oil produced from stripper wells, wells whose average production does not exceed ten barrels per day, was exempted from price controls under EPAA, later subject to price controls under EPCA, and then exempted again under ECPA. See *Domestic Crude Oil Prices*, *supra* note 4, at 10.

10. The Sporkin Task Force Report found FEA's compliance efforts ineffective, citing the temporary nature of the agency and poor coordination with regional offices as primary factors. [1978] 207 EN. USERS REP. (BNA) 13.

never succeeded in completing even a major segment of an audit of any of these companies.

The function of my office is to marshal the resources, the managerial skills and the legal and audit manpower to finish the audits of these thirty-four companies. Within this context, I have been given some priorities myself.

The first priority is to complete the audits of the largest fifteen¹¹ of those thirty-four companies by December 4, 1979, the date when my office was officially activated. My office was activated before I really had my manpower on board, and the clock was already running on my effort to audit the fifteen companies in two years. I am still in the process of trying to recruit about 120 more auditors and lawyers, and at the same time supplement those efforts with some temporary contractual support. On the other hand, I should acknowledge that I had an advantage with respect to Texaco and Exxon, the two largest of our target companies. The Department had started an experiment of intensifying those audits before my office was created, and I reaped the benefit of that intensification which perhaps balances the loss of manpower when I started. You may have noticed that the intensification of audit and legal activity at Texaco and Exxon has already led to some enforcement actions.¹²

The organization we have set up is somewhat different from the Department of Energy and the other federal agencies. Because we are a short-term operation, we have not found it practical to follow the normal mode of constructing a federal organization. We do not have ten federal regions as do other agencies because we do not have refineries in ten regions. We have divided the country into three geographical districts: the Northeast, the Southwest, and the Pacific districts. The three districts contain the lawyers, audit teams and supervisory personnel to handle the audit and enforcement activities involving the refiner pricing aspects of our comprehensive audits of these thirty-four companies. The natural gas liquids¹³ and crude production elements are being handled by specialized teams which have a national jurisdic-

11. The sixteen largest integrated refiners are: Amerada-Hess Corp., Arco- Atlantic Richfield Co., Cities Service Co., Conoco—Continental Oil Co., Exxon Corp., Getty Oil Co., Gulf Oil Corp., Mobil Corp., Phillips Petroleum Co., Shell Oil Co., Standard Oil Co. of Cal., Standard Oil Co. of Indiana, Sohio—Standard Oil Co. of Ohio, Sun Co., Inc., Texaco Inc.

12. See *Oil-Price Violation Charges Hit Texaco*, 5 OIL & GAS J. 94; *DOE says Exxon Overcharged \$70.8 Million on Crude Oil Sales*, [1978] 230 EN. USERS REP. (BNA) 7.

13. "Mixed hydrocarbon steam containing, in whole or in substantial part, mixtures of ethane, butane (iso-butane and normal butane), propane or natural gasoline." 10 C.F.R. 212.31.

tion. These teams will audit the largest fifteen of these thirty-four companies, and then the remaining companies as time permits.

I should speak a little bit about the problem of coordinating and integrating legal and audit skills. That was one of the sharpest criticisms leveled by the task force against the previous compliance activities of the FEA. Shortly after I started to work in the General Counsel's office, I found that there had been a lamentable breakdown in communication and coordination between legal and non-legal personnel working on compliance activities. We have taken corrective action as a result of that recommendation. The General Counsel has been given direct authority over Regional Counsels which it did not previously have. The counterpart institutional change removed compliance personnel from the direction of the Regional Administrators (who will now be Regional Representatives in the Department of Energy), and established clean lines of authority from the headquarters of the compliance organization to field activities.

I also have been fortunate in being able to work out an unusual arrangement with our General Counsel's office in which a significant number of attorneys have been made available full-time to support the Special Counsel's efforts. Currently I have thirty-four experienced compliance attorneys in the field in my three districts and will soon have about twenty-nine full-time lawyers in headquarters, working on what we hope will be a much more effective and integrated basis with audit personnel.

This brings me to a comment on another point that has been made, that some regulatory issues of interpretation went unresolved for an unfortunate length of time. I admit that there is some weight to that criticism, but it should be put in perspective. This was a brand new program, and it is not easy to superimpose a regulatory scheme on the complex and sophisticated American petroleum industry. It is unfair to say, after only three or four years, that this program is a failure because not all interpretations were resolved in the first eighteen months. I dare say if you go back and look at the IRS Code and the SEC laws that there was a growing up period, a juvenile period in those regulatory systems before they became mature and stable and as predictable as they are today. This is still a very new program, little more than an infant regulatory program. Having said that, I do have to acknowledge that there has been a problem of issuing timely clarifications. We are trying to improve that. We have established a special Assistant General Counsel for the Department of Energy whose exclusive re-

sponsibility is interpretation and rulings in compliance matters. Hopefully this will improve our performance.

I will now cover quickly a few of the major themes of the operation I am trying to undertake and at the same time respond to some of the thoughtful points that were made in the opening remarks. First, on the point of retroactivity, there has been a lot of criticism in response to our initial notices of probable violation to Exxon and Texaco regarding the use of retroactive interpretations. Let me say only that this criticism, frequently repeated, can go too far and can lead to a serious error of oversimplification. To some extent, all evolving regulatory systems involve clarifications after the fact, and a well-known judicial doctrine in administrative law acknowledges the right and duty of agencies to interpret. Every time an interpretation is issued, it to some extent raises the question of retroactivity. There are criteria for how, where and to what extent an interpretation may be retroactive, and how much notice has to be given. So it is not sufficient as a criticism to say that an issue involves retroactivity. The issues are whether it is permissible or impermissible retroactivity, and whether it is fair or unfair retroactivity. However, I caution you all to bear in mind that just talking about retroactivity does not begin to solve our problems. I have been charged with identifying all the unfinished major issues of regulatory enforcement under these pricing and allocation regulations and with making an independent review, with the help of the General Counsel, of whether the agency's position is correct and ethically tenable. If it is, it is then my job to gather the evidence and if necessary initiate an enforcement action. We are going to continue to do that even if it sometimes exposes us to claims of retroactivity in our decisionmaking. We feel such criticism is inevitable and the courts will have to determine whether we have stepped over the line.

Let me mention here a closely related point, the question of compromise. It could well be asked why any of the thirty-four companies would consider cooperation with an activity which so obviously could lead to considerable claims for overcharge violations? I think there is a practical reason. Sensible businessmen will realize that there is going to be government involvement in the oil business for a long time. Public confidence is going to continue to be an important psychological and political factor affecting the oil industry. Because of the confusion, difficulties, acrimony and the psychological climate built up through the embargo period, as well as the general public perception of the oil industry, it is in the industry's interest, as well as in the Depart-

ment's, to lay to rest in a professional, systematic way all of these nagging questions of whether the companies have massively violated the regulations.

At least for the next two years, I have an express delegation from the Secretary of the Department of Energy authorizing compromise of overcharge claims. I stress this because I am not so foolish to believe that even fifteen of the largest companies in the United States can be audited, that all the issues in dispute can be inventoried, and that actions can be brought and finished in two years. My assignment is to at least initiate those actions. It is not in my interest nor in the companies' interests to leave these things tied up in the courts, hovering like a black cloud of suspicion over the companies and over the government for many years to come. These questions should be put to rest as soon as possible, and this two-year period in which I have the authority to make compromises represents an opportunity, perhaps a unique opportunity to put these things to rest and close the books.

One of the reasons we have been able to produce this first generation of enforcement actions in the first sixty to ninety days is our willingness to take the calculated risk of decentralizing the processes of issue resolution and of enforcement action in the Special Counsel's office. In the past there has generally been a very conservative approach to enforcement; a tendency to impose a hierarchy of redundant review procedures. This is a standard problem with bureaucracies, especially new enforcement bureaucracies which are very nervous about making mistakes. One of the advantages of having a fixed time period, and perhaps of having a Special Counsel who does not intend to be a permanent government employee, is that this time period requires you to take certain risks and to adhere to certain demanding timetables. Also, we feel confident that we have experienced lawyers working with experienced auditors in the field and that we can delegate more authority to those people. We hope this will translate into not only quicker identification of enforcement issues, but also into quicker resolution of disputes with companies. The audit teams and the lawyers working with them, who know the company's problems and personnel intimately, will be available to work out reasonable solutions to these problems where the companies are interested in that kind of negotiation.

One of the approaches we intend to pursue more aggressively now than we have in the past is coordination with private actions brought by organizations or individuals both within and without the petroleum

industry. Those of you who are following our activities will notice that we recently intervened in a class action suit that was brought by some retail gasoline dealers against Union Oil in a federal district court in Minnesota. We did that without bringing any enforcement action inside the Department of Energy. We thought the issues were addressed in that suit and there was no reason to waste six months to a year in administrative proceedings. An early resolution of these issues will have a positive impact on the companies we regulate. The sooner we get decisions, the sooner we can apply the decisions to the rest of the regulated community and resolve some of these longstanding problems.

Finally, two small but important issues that remain unsettled are assessment of penalties and payment of overcharges to the United States Treasury. We have a tremendous difficulty identifying so-called injured parties. Conceivably, it could take months or years in some cases. We would have to advertise and perhaps set up some escrow system while in the process of identifying people who may have been injured. Some serious thought is being given to setting up an alternative system. It will provide for the payment of overcharges in narrowly and appropriately defined cases to the U.S. Treasury, after a period of notice is given to possibly affected private individuals so that their claims will not be extinguished by those payments.

I will stop now and invite any of you who are interested as laymen, attorneys, or as representatives of regulated companies, to feel free to contact my office and talk formally or informally about common problems whenever it is convenient and appropriate.