The original documents are located in Box 3, folder: "Testimony, June 23, 1975, Senate Committee on the Judiciary - Subcommittee on Administrative Practice and Procedure" of the Frank Zarb Papers at the Gerald R. Ford Presidential Library.

STATEMENT OF FRANK G. ZARB

ADMINISTRATOR

FEDERAL ENERGY ADMINISTRATION

Before the

SUBCOMMITTEE ON ADMINISTRATIVE

PRACTICE AND PROCEDURE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

June 19, 1975

Mr. Chairman and Members of the Subcommittee:

I welcome the opportunity to appear before this Subcommittee to discuss FEA's compliance program. It is appropriate that the Subcommittee has chosen the compliance program as the focal point for these hearings because effective and vigorous enforcement is the foundation of a successful regulatory program. Compliance with any regulatory program relies heavily on cooperation and obedience by the industry subject to those regulations. For the most part, citizens are willing to obey the law even when compliance involves enormous financial sacrifice (as it does in the FEA context), but only if they know that the government also requires everyone else to comply.

Mr. Chairman, in our conversations over the past few weeks, you have convinced me, and I hope I have convinced you, that we are both committed to the vigorous enforcement of FEA regulations. I think we are also both seriously concerned as to whether the FEA's current compliance program is adequate for the task. You and the members of this Subcommittee's staff are to be complimented on an unusually thorough inquiry into this subject. While to our knowledge the inquiry has largely discovered those problems with which we are already familiar, nevertheless, your inquiry has already been productive because you and your staff have given us, in the numerous discussions we have had over the past several weeks, a fresh perspective on FEA's

problems in the compliance area that will be helpful to us in solving them.

Rather than giving you here a detailed summary of what we have already done in the compliance area, most of which has already been provided to the Subcommittee staff, I think it would be more productive this morning if I focused specifically on the various issues and problem areas identified by your staff as being of particular interest to the Subcommittee. I will discuss the problems we have encountered in each of these broad areas, and describe the steps we have taken or are taking to deal with them.

After my statement, I would be happy to respond to your questions. I have brought with me Mr. Robert Montgomery, our General Counsel, and Mr. Gorman Smith, the Assistant Administrator for Regulatory Programs, and knowledgeable members of their respective staffs to assist me in answering your inquiries.

Manpower and Budget for National and Regional Compliance Programs

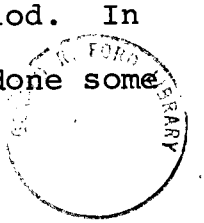
The question of the appropriate resource level for compliance activities has been and remains an especially difficult one. Clearly, we must have a level of resources adequate to support a vigorous and effective compliance program. At the same time, we have a responsibility to see that the resources we do have are employed as efficiently as possible.

I will not review in detail the history of our compliance staffing. The specifics have been provided to the Subcommittee staff. I do believe it is important to understand the principal milestones in the program's development because our present situation stems from them.

First, we must remember the conditions under which the agency was created. It was pulled together overnight by combining numerous segments of other government offices, adding large number of detailees from other departments and agencies, and hiring a number of new employees. It confronted an entirely new problem with which none of us had any direct experience. Most of the people involved had little direct knowledge of the industry's complexity. We were in a true emergency situation, with a premium on decisive action.

Given the difficult nature of the problem confronting the agency and the trying circumstances always associated with the creation of a new organization under emergency conditions, the agency has really done a remarkably good job of discharging its congressional mandate. It met the challenge confronting it and brought us through a trying and dangerous period with minimum disruption of our economy and our society.

There were, of course, mistakes made in this period. In retrospect, it is clear that we probably should have done some



things differently although I might add that it was much less clear at the time the hard decisions had to be made. We have learned from these mistakes. Many of them have already been corrected, and others are now being corrected. As we have gained experience, we have learned how to do our job better, and we will continue to improve our performance.

While we welcome and indeed encourage constructive criticism and suggestions for improving our programs, we do believe it important to evaluate those criticisms in light of the agency's overall performance of an extraordinarily difficult task under trying circumstances.

One of the most trying of those circumstances still impacts on the program's effectiveness today. From the outset, FEA's entire regulatory activity, to include compliance, has been conceived as only a temporary program. At first, it was due to expire on February 28, 1975, only 14 months after it began. Now, it is due to expire on August 31, 1975, still only 20 months after it began. This has made it difficult to plan for and execute an adequate staffing program. It has been hard to plan future requirements and to attract fully qualified and dedicated people to an agency that offered very limited job security. We were able to staff most of our positions initially with employees from other agencies, principally the IRS, but they hold reemployment rights which some of them exercised either because they thought they saw the first sign

of the program's demise, or simply for personal reasons. Accordingly, the program has experienced unusually high turnover.

Nevertheless, despite these obstacles, by the summer of 1974 we had been able to assemble a total field compliance staff of approximately 850 employees. This is roughly 25 percent of the agency's entire staff and is by far the largest single program in the agency. One of the issues before this Subcommittee, however, is whether that program is big enough.

When I came to FEA last December, one of my first actions was to ask for a briefing on our compliance program. At that time, I was informed of the redeployment of people and change in program emphasis that was underway in response to the agency's own evaluation of its program, undertaken when FEA assumed responsibility for the programs from the Internal Revenue Service in June, 1974, and a draft General Accounting Office report issued in September, 1974. I was also told that the authorized staffing for the regional compliance program was scheduled to be reduced from a December 31, 1974, level of 784 to a June 30, 1975, level of 711. I immediately directed that this planned reduction be canceled, that the staffing level be maintained at no less than 784, and that a total of 20 new attorneys and appropriate clerical staff be added at the national and regional levels to increase our legal input into these cases.

I also questioned whether this was enough to do a thorough job of enforcing our regulations and was convinced that it was

not possible to make a firm judgment on that issue until a number of measures that were then underway to improve productivity and efficiency had been tested. I directed that those measures be expedited and that I be informed as soon as we could make a judgment on the adequacy of this staffing level.

The follow-up report to me makes clear that we underestimated the size and complexity of the compliance task as our program emphasis shifted away from the retail sector toward crude producers, additional effort on refiners, and more emphasis on wholesalers. In particular, our special program to audit suppliers of utilities turned out to be considerably more complex than we had anticipated.

Accordingly, I have recently directed that an initial increment of 50 additional personnel be hired for the utilities program by July 1, 1975. These positions were advertised in accordance with Civil Service regulations on June 10; and action is under way to bring these people on board.

Concurrently, I directed the development of a staffing plan and request for a supplemental appropriation to augment the request for this program submitted in the President's fiscal year 1976 budget. This plan is now nearing completion. It is expected that I will be asking the Congress for additional funds to support this effort.

I also requested the General Accounting Office to review our utility supplier effort in the context of the total compliance workload and give me its views on the most effective use of our resources. Last Friday, they informed me that in their opinion they did not see a need for a discrete utilities project and that sales to utilities should be tracked as part of our general refinery or wholesaler audits. They further recommended that no additional staff be assigned to the utilities project and that we begin a gradual phase-out of the current program.

I discussed this recommendation at length with the GAO staff, and I think we reached agreement that overcharges to utilities during the embargo could not be ignored and that it was in this area where many questionable and perhaps criminal activities could have taken place. Thus, while the GAO gave us some very useful suggestions and information, I remain more convinced than ever that the FEA needs to expand its efforts in the utilities project temporarily in order to assure the American people that the high electricity rates they are paying are at least no longer the result of unlawful pricing of fuel oil.

The GAO team also gave us some useful insights into other aspects of our compliance operations. They pointed to areas where we could improve communication among our working level people in different regions as a way to speed up the processing of cases involving two or more regions. They also

suggested that we needed more definitive guidance to the regions on selection of targets for audit, the scope of the audit effort, and the time period covered by the audit. Their suggestions will be helpful in our subsequent decisions in this area. In fact, I have asked for the GAO to give us even more help on the question of targeting of audit effort and other aspects of the program so that we can benefit from their own unique background and experience in this area. We look forward to a continuing relationship with them as we upgrade this program.

Finally, I should point out that we are no longer staffing for a temporary, short-term compliance program. As the President's proposal for decontrol of old oil is adopted, at least some of the existing regulatory authority will be extended for two years or more. Accordingly, we are now for the first time planning to continue our compliance effort beyond the time that our current regulatory authority expires until we have completed a comprehensive audit of regulated industry pricing practices, particularly during the period of the embargo. I view this as necessary both to assure the public that it was not paying unlawful prices for products during the period the regulations were operative and to assure the majority of firms that have complied voluntarily with our regulations that all others have been made to comply as well.

We realize that we are going to have to operate with a finite level of resources. Realistically, that level may not permit us to do everything we would like to do as fast as we would like to do it. It is our responsibility to determine the level of resources required for an adequate program and assure that those resources are used in the most efficient manner so as to get the maximum returns from them. Then we must analyze the nature of the entire compliance task to establish priorities of effort within the overall program.

This is, of course, what the agency has done in the past, using the information available to it at the time. We know now a great deal more about these issues than we did three to six months ago. Accordingly, we are now in the process of using that new knowledge and the new perspective of a program that will continue for some extended period to develop a better plan for how many people we need and how we can use them most effectively. The execution of this plan will be monitored closely and revised as necessary in response to what we learn as our program develops. One problem in the past has been the lack of a clear perception on the part of some regional administrators as to the high priority the compliance effort deserves. This has resulted in several instances of detailing compliance personnel to other agency programs or to locally initiated projects. Directives have been issued that this practice be stopped, and it will not be permitted to recur.

Scope, Conduct and Adequacy of Audits and Case Resolution

Several of the items on the list of subjects that your staff said would be covered by these hearings involve subjects such as whether we had assigned the proper priorities to various aspects of the program, whether there have been unnecessary delays in processing compliance cases, and whether we have adequately kept track of pending cases. In the interest of time and because several of these areas overlap, I would like to treat these various subjects under the broad headings of management effectiveness as well as resource commitment and level of effort.

a. Organization and Lines of Authority -- FEA's short history--it will be one year old on the 27th of the month--has been marked by growing pains. Organization has been one of them. The issue of national/regional relationships was brought to my attention in conjunction with the review of the compliance program I asked for in December 1974. There has been considerable debate within the agency itself as to whether, in the interests of proper management and uniformity, there should be greater or lesser autonomy in the region regarding the compliance program. The proper balance between national and regional control will play a large part in improving the compliance program.

In February, an issue paper was prepared and submitted for my consideration setting out a division of responsibilities in the compliance program between the national and regional

offices. However, the issue was too narrowly drawn since the same issue of national/regional relationships existed in other FEA program areas and these involved major considerations with long-term implications for the way the agency was going to operate.

b. Internal Controls -- Up until very recently, FEA management processes were accomplished in support of the general guidelines of the Management by Objectives Program. Our management staff was directed more towards the development of organizational structure and management guidelines of the agency than towards critical review and evaluation of the agency's operational programs.

Recognizing the inadequacies of this system, I directed the development of formal operational programs for FY 1976 for both the headquarters and regional offices. These Headquarters and Regional Operation Plans (HOP and ROP) outline specific prioritized program goals and objectives, delegated authorities and responsibilities, resource requirements for the accomplishment of the stated objectives, and--more importantly--designed milestones and quantitative performance factors against which program execution can be evaluated.

Biweekly performance reporting will be required from all regional and headquarters offices. In addition to incorporating these data into operational reports for my use, the management staff will provide continuous program evaluation with the authority to recommend a program modification/adjustment,

trade-offs among programs, and the redistribution of available resources, as required.

This staff will deal directly with the operational program offices to improve the execution of the program and the accomplishment of the established goals on a timely and effective basis. This formal program review and evaluation function will be supplemented by periodic management conferences of our program executives to address program accomplishments and problems encountered.

The Headquarters and Regional Operation Plans include not only specific delegations of authority, but also a more precise delineation of the roles of the national and regional offices in the treatment of cases. Both these elements should go far toward resolving the questions of national versus regional responsibility and improve the working relationships among the various organizational elements involved in compliance.

c. Adequacy of Guidance from the National Office -- While the time required to develop a comprehensive operating plan may have contributed in certain cases to a lack of uniformity among regions, this has not been the only cause of such variability. Rather, regional variability has been an inevitable product of the decentralized way in which the

compliance program developed, coupled with the exceptionally heavy demand for guidance from the national office during the program's early months. This demand, and the problems encountered in meeting it, were intensified by the complexity of the regulations, the great haste with which they were originally drafted, and the frequency with which they had to be amended in response to changing market conditions.

We have already made substantial progress in this area. A major element of the compliance action plan, which I approved in January 1975, was the development of better guidance and direction to the regional administrators on the conduct of compliance activities. Because we recognized the immediate needs for such material, it has been issued as developed in a number of separate directives. Since January 1, 1975, there have been 49 items of program guidance issued by the national office, and it is reported to me that these have improved substantially the uniformity among regions -- even though we still have a long way to go.

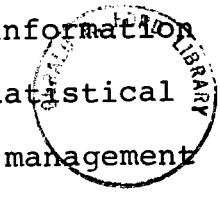
These directives and other necessary material are being incorporated into a comprehensive compliance manual that will codify in one place our procedures, guidelines, and policies. This manual, which is to be issued soon, will address the entire compliance process and provide detailed guidelines and standards for program development, program operations, case resolution, and administrative activities. The manual will contain detailed background material for orienting compliance personnel to the petroleum industry and the regulatory environment, and will provide a means for insuring that high-quality work is performed within all regions and the national office by specifying uniform policies, procedures, and reporting requirements designed to assure quality control and uniformity.

The manual has already benefited from the work of your staff and the GAO, who have identified certain areas that need additional emphasis. We also intend to consider the findings of these hearings in the development of the final version of the compliance manual. The manual will be kept up to date by the addition of new or replacement issuances and will serve as the standard reference for FEA compliance activities.

d. Case Control and Management -- Another significant problem area that has troubled us for some time is that up to now the FEA has not had a fully adequate case control system. After the transition from IRS, we developed a compliance case control and tracking system and initiated it in August, 1974. During the few months following the initiation of the system, various problems arose and were solved, and we managed to incorporate a sizable backlog into the system.

In January, 1975, the first of what were intended to be regular reports on regional and national office case activities was extracted from the system. During February, however, in an effort to centralize and improve the efficiency of all agency data functions, the compliance case control system had to be reprogrammed and incorporated into the new, centralized computer system. While this means that we have had to do case management with a manual system, this conversion process is now nearly complete. The new system should provide the necessary capability to trace, monitor, and analyze all compliance case activities.

The overall objective is to develop and implement a system which integrates the case control and tracking, weekly activity reporting, and monthly time reporting systems. From this comprehensive data base, the national compliance office will be able to extract complete and up-to-date information regarding individual cases or types of cases. Statistical and other reports will be produced that will aid management



in such areas as manpower planning and evaluating compliance performance.

e. Delays in Processing Enforcement Actions -- While we are normally more concerned with the correctness of our compliance actions than with processing speed, nevertheless there have been too many unnecessary delays in processing enforcement actions. Several factors have contributed to these delays. One obvious problem is that the regulations have become increasingly complex as a result of continuing efforts to be thorough and fair in our regulatory impact on consumers, producers, refiners, and distributors. These regulations are subject to continuous review, revision, and updating in response to changing economic conditions and new programs. Rapid and definitive interpretation of these regulations has become increasingly difficult, and this impacts upon timely progress in issuing enforcement actions.

Another source of delays has been the normal problems to be expected from the start-up of a new agency operating under emergency conditions. New people were assigned to unfamiliar tasks after only limited training so as to get somebody on the job and working. As they dug into the facts in specific companies and tried to apply our regulations to them, a number of difficult issues were identified. The newness of the entire program meant that there was no established body of rulings, case law, and interpretations that characterizes a long-established agency such as the Internal Revenue Service, for example. The only way to

assure reasonable uniformity was to centralize the review and approval process. We had to trade time for acceptable quality controls, a problem compounded by the absence of enough specific and detailed guidance to meet all the needs of the people in the field. Accordingly, it has simply taken a long time to resolve some of these issues.

These problems are typical for a new agency gearing up to operate a complex regulatory program. We are, however, taking steps to speed up the process. As I indicated earlier, we have formalized lines of authority, and we are in the process of improving upon our guidance programs and case management system. Moreover, we have contributed substantially to the solution of this problem in the General Counsel's office by creating on March 1, 1975, a separate compliance division that can give full time and attention to resolving legal questions in the compliance context. But, I feel the most significant improvement necessary to accelerate our turn-around time on enforcement actions at the national level, especially for our refiner and utility supplier cases, will be a new procedure we intend to implement on July 1 for case resolution.

Case resolution will begin when the investigation has been completed and reviewed for adequacy of scope, detail, and documentation. In other words, the investigative function will be viewed as being separate and distinct from the case resolution function.

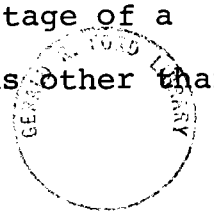
In the national office, we intend to assign personnel to a separate office of case resolution. This office will have complete responsibility for taking a case from the point where the investigative portion is completed to the final resolution of all remedial enforcement action. Each case will be assigned to a case analyst who will head a team consisting of himself and an attorney from the Office of General Counsel, and they will have direct access to the investigator responsible for the case in the region. They will review the case; decide what, if any, enforcement action is necessary; and approve or modify the appropriate documents and transmit them to the region for implementation. The regional office will monitor the firm's subsequent compliance by conducting follow-up investigations to the extent necessary.

We feel that by assigning all resolution responsibility in a particular case to a small and identifiable group of employees, this case resolution procedure should result in both an improvement in the processing of compliance cases and in the uniformity and accuracy with which they are handled.

One final point needs to be recognized when treating the issue of delays in case processing: FEA's ability to process

an enforcement action quickly is substantially greater than that of most regulatory agencies. Notwithstanding the delays we have experienced and the clear need for the corrective actions we have initiated, we have still been able to resolve the vast majority of our cases in what are very reasonable times for Federal regulatory actions.

Our procedures have been kept informal so as to provide a timely mechanism for enforcing FEA's regulations. But while we need to be expeditious, care must be taken to insure that the due process rights of companies involved in compliance proceedings are not infringed. The FEA has taken several steps recently to assure necessary procedural safeguards. First, in September 1974, it adopted revised procedural regulations that substantially broadened the rights of persons appearing before FEA. Second, by expanding the legal staff involved in compliance proceedings we are assured of adequate legal input into each decision. And, third, we have changed the use of NOPV's from information-gathering devices to formal written notices of charges that are set out in some detail. A specific directive was issued to the Regional Offices on April 30, 1975, precluding the use of a Notice of Probable Violation (NOPV) until a "significant stage of a factual investigation has been completed ..." and as other than a



formal notice of charges. While these measures may add some time to completion of some cases, we deem them essential to preserve the rights of the parties subject to FEA action.

Policy, Practice and Procedure with Respect to Choice and Processing of Enforcement Actions

One of the subjects listed by your staff as of particular interest was FEA's policy, practice and procedure on the choice and processing of enforcement actions. FEA has authority to issue orders, called remedial orders, which require companies that have violated the regulations to cease their unlawful practices and to make restitution to injured parties. A remedial order is usually preceded by an informal proceeding in which the company is served with a Notice of Probable Violation outlining the charges and is given the opportunity to file written comments and have a conference with the FEA.

To date, the regulations prescribing procedures for FEA compliance actions have not provided an explicit means for finalizing those compliance actions in which a firm may be willing to undertake certain remedial action satisfactory to the FEA with or without conceding that it has, in fact, violated the regulations. In the past, many firms have offered, and the FEA has in many cases agreed to, settlement of a case by making full restitution but without having to concede a violation.

Those settlements have ordinarily been formalized in written agreements, so-called "consent agreements," which the FEA believes are binding on the parties and have the same force and effect as a final order of the agency. However, since such written agreements have never been expressly provided for in the procedural regulations, there has been some uncertainty as to the status of outstanding compliance agreements and considerable inconsistency in the use of voluntary settlements of compliance cases. For example, our own investigations have uncovered instances in which so-called compliance agreements in cases potentially involving millions of dollars have been nothing more than a letter signed by only one party confirming an oral understanding. A particularly glaring example of deficient procedures occurred when a letter from a major oil company's attorney written to confirm the company's understanding of the agreements reached at a meeting with FEA compliance staff members the day before was deemed by the staff to be a "compliance agreement." FEA did not even acknowledge the letter. When senior legal and compliance staff members became aware of this situation, a letter was

dispatched to the company informing it that FEA did not consider itself bound by the terms of the company attorney's interpretation of the agreement reached at the meeting.

To preclude such misunderstandings in the future, on May 14, 1975, the FEA issued a Notice of Proposed Rulemaking to expressly provide for a consent order procedure similar to that used by the FTC and other regulatory agencies. Comments have been received from the public in response to the Notice and it is anticipated that, pending a comprehensive evaluation of those comments, the final consent order regulation will be formalized in the next few weeks.

Among the comments received were suggestions that FEA adopt a procedure analogous to that of other agencies and place proposed consent agreements on the public record for a 30-day period prior to executing them. We are currently considering the adoption of this procedure as a way to assure that all parties affected by the agreement, even indirectly, have an opportunity to represent their interests before the agreement is concluded.

Policy, Practice and Procedure with Respect to Remedies and Penalties

The questions which have been raised regarding FEA's policies, practices and procedures with respect to remedies and penalties has, I think, been largely the result of a general misunderstanding of FEA's actual policies. The FEA's policies can be stated plainly and simply: In every enforcement action the FEA strives (1) to halt the unlawful practices; (2) to attain full and complete restitution to injured parties; and (3) to extract a penalty, where appropriate, that is commensurate with the seriousness of the violation and will provide a deterrent to others.

Thus, each remedial order or consent agreement issued or entered into by the FEA orders the violator to cease and desist from continuing the same violation, and it also has a provision for a remedy. In a pricing case the remedy is a refund if the victims are identifiable and a "rollback," or a reduction in what current selling prices would otherwise be, if victims are not identifiable. In allocation cases involving failure to supply product at some prior period, it is sometimes difficult to fashion a remedy because it seldom is of much use to order a payback of product at a time when most purchasers have more product than they need.

In such cases, when a prospective remedy is inappropriate, the FEA makes an effort to obtain a substantial civil penalty instead so as to preclude future allocation violations. In three cases of this kind, the FEA successfully collected $535,000 in civil penalties.

Fashioning a remedy in a pricing case is usually not a simple task except at the retail level. A serious problem in simple refund cases is assuring that the refunds find their way downstream to the persons originally overcharged -- usually, but not always, end users. This is particularly a problem because it is unfair to impose upon middlemen the burden and administrative expense of computing and distributing a refund among all of their customers.

One technique we have used is to require any downstream recipient of a refund to treat the amount of the refund as a reduction in his product costs for the month in which it is received. This causes them to set their prices lower than would otherwise have been the case, thereby passing the benefit of the refund on to end users.

The important point is that in case a refund is mandated at any level of the distribution chain, the benefit of that rebate goes to the individual who was overcharged where feasible and to the particular group of customers who were overcharged where it is not feasible to identify amounts of individual refunds.

For example, when we find a utility supplier price violation and direct a refund, we notify the state ratemaking

authority of the amount of the refund going to the utility. Because the utility itself is beyond FEA's jurisdiction, it is then up to that state body, or to the Federal Power Commission for utilities it regulates, to determine how the refund will be used to benefit the utility's customers.

The fact that most major oil companies have large amounts of "banked" or unrecovered costs that they can pass through at some future time does not, contrary to what many people think, present a serious problem with regard to remedies. The FEA does not allow a company that has actually overcharged any purchaser to "remedy" the violation by reducing banked costs by an equivalent amount. Our rule of thumb is that if a company unlawfully took money out of the marketplace, it is required to put that money back into the marketplace. It may be true that in the period immediately after the embargo, when there was some confusion in this area as banks began to accumulate, some remedial orders and compliance agreements improperly allowed companies to offset overcharges during the embargo with adjustments to current banks. But, the FEA has for some time had a steadfast policy against such a practice. That policy has been clearly stated to the FEA regions in Ruling 1974-26 and in the guidelines to the regions issued on the application of Ruling 1975-2.

That is not to say that the FEA does not sometimes allow violations to be remedied by bank adjustments. But,

that is true only in those cases where the violation itself resulted only in an improper upward adjustment of banked costs.

In addition to its own internal compliance proceedings, the FEA has authority to refer to the Attorney General for criminal prosecution cases involving willful violations and, for the imposition of civil penalties and/or injunctions, other kinds of cases. It is our policy to refer to the Department of Justice all cases involving evidence of willful misconduct and to let the Department determine whether a prosecution is warranted in the circumstances. There should be no misunderstanding on the part of anyone either within or without the government on this score. Any evidence pointing to criminal activity, to include disregard of or willful intent to evade FEA's regulations, will in every case be forwarded to the Department of Justice for its determination as to disposition. Written instructions have been issued to the compliance staff as to the specific procedures to follow whenever they encounter in the course of an investigation evidence of criminal activity of whatever nature.

The maximum penalty for willful violation of FEA regulations is $5,000 per violation; there is no provision for a jail sentence. A civil violation carries with it a maximum penalty of $2,500 per violation. The FEA has determined that each day of violation constitutes a separate violation for purposes of the penalty provision although it is not clear that that position would be sustained if

challenged in court. We have submitted to the Senate Interior Committee, in connection with hearings on the extension of the Emergency Petroleum Allocation Act, the suggestion that the penalty provisions be amended to clarify our authority to treat each day of a continuing violation as a separate violation and to provide for penalties that can be more readily tailored to the seriousness of the violation.

The FEA's authority to refer cases to the Department of Justice for injunctions and penalties is a useful augmentation of the FEA's internal administrative procedures. However, these remedies are time-consuming and expensive to obtain if they have to be litigated in the Federal courts. Therefore, the FEA has generally elected to accept from a violator in noncriminal cases the payment of a civil penalty in lieu of referring the case to the Department of Justice. Over $900,000 in civil penalties has been collected by FEA through such negotiations. The criteria that the FEA applies in determining the amount of civil penalties to collect in a particular case have been outlined in the written materials that have been given to the Subcommittee in response to the Chairman's April 24 letter.

Heretofore, the case files on completed penalty cases have been available for discovery under the provision of the Freedom of Information Act. Henceforth, we plan to make such case files available in FEA's public document room.

The Use and Effect of Rulemaking in the Compliance Context

Concern has been expressed that the FEA's regulations have in some instances been inadequate for compliance purposes and that delay in curing the deficiencies may sometimes have influenced the substance of the solution. For example, it has been suggested that delay in solving problems with the regulations has caused overcharges to accumulate to such a degree that the FEA has solved the compliance problem by retroactively making lawful what were previously unlawful practices. FEA's treatment of natural gas liquids (NGL's) has been cited by some as an example of this result. I would like to address that specific example because it helps to point up the complexity of the regulatory problems involved in compliance cases.

There is no question in my mind that it has taken too long for FEA to come to grips with the NGL problem. It was clear that the Cost of Living Council intended that NGL processors would be covered by the Phase IV regulations applicable to refiners, which regulations were later adopted by the FEA. However, those regulations were difficult to

apply to NGL processors because they did not expressly deal with physical distinctions between the extraction of propane and butane from natural gas and the refining of those products from crude oil. Moreover, since the Emergency Petroleum Allocation Act nowhere specifically mentions natural gas liquid products, the question has been raised as to whether the FEA has had authority to regulate NGL's after the expiration of the Economic Stabilization Act on April 30, 1974.

The FEA should have recognized and dealt thoroughly with the problem in the spring of 1974 when the problem first came to its attention. However, because of the press of other matters, its direct response was unduly delayed. On May 16, 1974, FEA first addressed this issue in a notice of proposed rulemaking with respect to its allocation regulations and stated that it had authority to allocate natural gasoline. When the final rules on the allocation of natural gasoline were adopted on July 2, 1974, FEA's authority over that natural gas liquid product under the EPAA was extensively discussed in the preamble. On July 25, 1974, an interpretation was issued to the effect that products processed from NGL's are considered by the FEA to be subject to the refiners' price rules. That interpretation was affirmed on appeal to the Office of Exceptions and Appeals in November, 1974. Then, on August 5, 1974, FEA issued a special propane emergency price rule which specifically stated rules for the pricing of propane

extracted from natural gas. Finally, on September 6, 1974, the FEA again reiterated in a notice of proposed rulemaking that it considered NGL processors to be subject to FEA price regulation. That notice for the first time proposed a separate set of regulations tailored to all NGL's.

It was not until December 24, 1974, shortly after my confirmation by the Senate, that the FEA was able to complete the rulemaking proceedings and adopt a final regulation covering NGL's, effective January 1, 1975.

This new regulation solved the problem prospectively, but it left the question of whether and the extent to which the FEA was going to apply strictly its refiner price rules against NGL processors for the period prior to January 1, 1975. Some regional compliance personnel strongly urged literal application of the refiners' formula. Other FEA personnel, however, believed that such a rigid approach would be unfair, given the fact that the refiners' price rule was not designed with the particular characteristics of NGL processors in mind. Some members of the industry argued for no enforcement at all on the theory that most of them were unaware of the application of FEA regulations. While the FEA believed that the industry had adequate notice that it was covered by the FEA regulations, it was nevertheless concerned, both from a legal standpoint and on grounds of basic fairness, that strict application of the refiners' rules would mean that NGL processors would be held to rules that, if they had been complied with, would have placed

them at a severe competitive disadvantage in relation to competitors that refined the same products from crude oil.

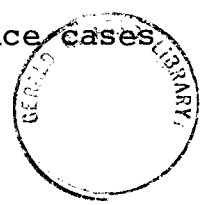
Therefore, on May 29, 1975, the FEA published Ruling 1975-6, which construes the refiners' price rules so as to allow NGL processors to treat increased shrinkage costs as increased product costs under the refiners' price rules. Moreover, the FEA has, by notice in the Federal Register, proposed a class exception that, if adopted, will allow retroactively the same adjustment of May 15, 1973, selling prices that is allowed by the rules that have been in effect since January 1 and will allow increased nonproduct cost pass-throughs of up to one-fourth cent per gallon. In short, the FEA has proposed that for the period prior to January 1, NGL's be regulated on essentially the same terms as they have been after that date.

It has been suggested the the FEA took this action at least in part in order to eliminate a major compliance problem. That is not so. The principal reason for taking this action was to put NGL processors on an equal footing with their refiner competitors. Rigid application of the refiners' rules would have meant that NGL processors would be held to May 15, 1973, selling prices, which in some cases were as low as three or four cents per gallon, while their refiner competitors were allowed to increase their prices to reflect the increased costs of crude oil. Moreover, the

FEA had necessarily concluded when it adopted the new rules for NGL processors that the old rules were inequitable and not rational as applied to NGL processors. Therefore, without the steps the FEA has recently taken, the FEA ran the risk of having the courts prevent the FEA from taking any compliance action against NGL processors for the period prior to January 1.

The FEA has only begun its compliance effort in this area. However, despite the lateness and the enormity of the effort required, the FEA intends to audit all significant processors of NGL's for any pricing violations committed prior to January 1, 1975, and to order appropriate refunds where violations are found. This task will be difficult and expensive. It will require assembling and training a substantial number of auditors who will specialize in this area. Moreover, it will require the agency successfully to defend in court the cases currently challenging our NGL regulations and the numerous cases that will arise once enforcement begins. However, we are committed to seeing this matter through.

The NGL problem points up some salient facts about FEA's compliance process. In the first place, it demonstrates the complexity of issues raised frequently in compliance cases.



as the agency develops the body of interpretive actions required before the rules can be applied to the widely different factual circumstances found in the industry. Second, while it may take us some time to sort out these extremely complex problems, the FEA is determined, once it has reached an equitable solution, to apply that solution retroactively where appropriate and fair rather than letting bygones be bygones.

Conclusion

Finally, Mr. Chairman, it is clear that the areas this Subcommittee is examining, which really turns on the question of effective management of our compliance effort, is still in the process of being meaningfully improved. Members of our professional staff in the field and at the headquarters have undoubtedly experienced a series of frustrations, delays, or difficulties during the short history of our organization and the evolution of its adjustments.

Unfortunately, there is no way to bring the level of our operations up to desired levels of efficiency and effectiveness in a few days, a few weeks, or even a few months. However, we have embarked on this task in a way that will build a sound foundation for our activities rather than simply fight fires from day to day. We are committed to completing this strengthening process, and I give you my assurance that this commitment will remain as long as I have this responsibility.

Within the last 60 days, the Senate has confirmed the appointments of two key people who will be responsible for much of the implementation of our plans, Mr. John Hill as Deputy Administrator and Mr. Smith as Assistant Administrator. The Senate now has before it the President's nominations of Mr. Eric Zausner as Deputy Administrator and Mr. Thomas Noel as Assistant Administrator for Management and Administration.

These key people share my commitment to upgrading our compliance program and our other programs as well. With them in place, I expect to see the pace of improvement pick up sharply.

We recognize a responsibility for compliance efforts that will extend well beyond the expiration of our current regulations. We must complete a thorough audit of the industry's practices, especially during the period of the embargo, to assure the Nation's consumers that they have been treated fairly. Because of the particular vulnerability of utilities to overcharges, which stems from their requirement to continue to provide service and the fact that some of them may have been in a position to bargain less hard for supplies of fuel than other customers, we need an expanded effort in this aspect of the program. Our refinery audit program needs more manpower and better procedures, and producer audits need to have additional effort.

Moreover, we must be prepared to respond to future developments more rapidly and effectively than we have been able to do in the past. We must assure not only that FEA's regulations are complied with, but also that any evidence of criminal intent is brought immediately to the attention of the Department of Justice for appropriate action.

I have reviewed with you today in general terms some of the initiatives we already have underway toward these ends and others we will take soon. More important even than these, in my view, is the way we approach this responsibility. We are determined to learn from our mistakes and from our successes and to continue taking whatever measures may be required to improve our programs.

A great deal of progress has been made but as you can see we still have some distance to go. I am absolutely certain that we will make important improvements as quickly as we can. To do so is our clear responsibility, and we are all committed to discharging that responsibility to the end that FEA's regulations are enforced to the maximum extent of our capability.

These hearings as well as continued counsel with the GAO will provide FEA with new information and guidance, all of which is helpful in achieving the results we all want.