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

**RELEASED**

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February 9, 1976



The Honorable Les Aspin  
House of Representatives

Dear Mr. Aspin:

Your letter of April 7, 1975, asked us to examine Gulf Oil Corporation's "double dip" permitted by the Federal Energy Administration's (FEA's) regulations for crude oil and to determine whether appropriate corrective action was taken by Gulf. Double dip is a term used to refer to a practice resulting from an FEA regulation interpreted by Gulf and several other oil companies to permit them to potentially recover certain increased product costs twice. However, most of the total increased product costs in question were not actually double dipped since these costs were not passed on to the consumer in the form of increased prices. For the most part these costs were "banked" for a potential second recovery in the form of increased consumer prices at a later date.

We examined FEA audit reports and related workpapers and interviewed FEA headquarters officials, the FEA audit team leader assigned to Gulf, and a Gulf official.

We found that Gulf overbanked \$119.7 million from February to September 1974 but did not pass any of this amount through to its customers. In June 1975 Gulf signed an agreement with FEA to take the proper corrective action to eliminate these costs.

BACKGROUND

The Emergency Petroleum Allocation Act of 1973 (87 Stat. 627) was to help minimize the adverse impacts of short-term petroleum shortages by placing equitable restrictions on supply, cost, and profit. The act, which was the basic legislative authorization for controlling petroleum product prices, expired on December 15, 1975. On December 22, 1975, the President signed into law the Energy Policy and Conservation Act which amended the Emergency Petroleum Allocation Act of 1973 and extended it until September 30, 1981.

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The Federal Energy Administration Act of 1974 (88 Stat. 96) provided for a reorganization of governmental functions, on an interim basis, to deal with energy shortages. FEA carries out the petroleum pricing provisions of the Emergency Petroleum Allocation Act.

To bring about the legislated energy goals, FEA and its predecessor, the Federal Energy Office, established a series of regulations on January 15, 1974, governing the allocation and price of crude oil and refined petroleum products. Generally, the regulations permit refiners to charge their prices effective on May 15, 1973, plus a dollar-for-dollar passthrough of any increases in product costs incurred after that date. Further, when the firms can substantiate increases in nonproduct costs, such as labor or overhead, they may be allowed additional price increases.

The regulations also provided for a mandatory crude oil allocation program. This program was to provide equitable sharing of crude oil supplies among refiners. Under the program, refiners with crude oil supplies in excess of the national average were required to sell crude oil to refiners whose crude oil supplies were less than the national average.

The regulations provide for banked costs which are paper-cost increases accumulated under a cost carryover provision of the price regulations. This provision allows refiners to "bank" cost increases which the firm feels cannot be immediately passed on in the marketplace and recover these costs through future price increases.

Included in these regulations was section 212.88 (e) which stated:

"Refiners required to sell crude oil under this program [section 211.65--mandatory crude oil allocation program] shall be allowed to increase their product prices to reflect increased crude oil costs of all available crude oil prior to making crude oil sales to comply with this program."

Thirteen refiners interpreted the above provision to permit the increased cost of crude oil sold in the mandatory crude oil allocation program to be recovered both in the price of the mandatory crude oil sales and potentially in the increased cost passthrough.

For example, suppose a refiner's weighted average crude oil cost was \$4 per barrel for the base period of May 1973, and under the mandatory crude oil allocation program, FEA directed the refiner to

sell crude oil to another refiner at its weighted average cost, which at the time of the mandatory sale had increased to \$10 per barrel. As written in the January 15, 1974, regulations, section 212.88 (e) was interpreted by some refiners to allow the refiner to

- recover the \$10 per barrel cost through the mandatory sale to a small refiner, and
- recover the \$6 (\$10 - \$4)-per-barrel increase in its crude oil costs either by passing this cost through to the consumer in the form of increased prices or by banking the \$6 crude oil cost increase for passthrough to the consumer at a later date.

In this example, the refiner could interpret the regulation to permit it to recover the \$6 per barrel increase from both the mandatory sale of that barrel and the increased cost passthrough on the same barrel. In May 1974 FEA revised its regulations by deleting section 212.88 (e).

#### TOTAL AMOUNT OF OVERBANKING

From February to September 1974, 13 refiners overbanked increased crude oil costs in the amount of \$309.1 million. Two of the 13 refiners passed through \$0.7 million and \$0.4 million, respectively, of the increased crude oil costs to their customers. In May 1974 when FEA issued its revised regulations, 12 refiners discontinued overbanking. Gulf continued to overbank through September 1974 because it was not certain whether the revised regulations disallowed this practice. Gulf requested an FEA interpretation on whether a refiner could overbank under the revised regulations. In November 1974 FEA issued a ruling explaining the proper method of calculating increased crude oil costs under the mandatory crude oil allocation program. This method eliminated the possibility of overbanking these costs.

Subsequently all 13 refiners agreed to reduce their banked costs by the amount that they had overbanked. Each refiner, except Gulf which adjusted its bank in June 1975, made the necessary bank adjustments prior to January 1975. Two refiners made consumer refunds of \$0.7 million and \$0.4 million in April and May 1975. FEA officials said all bank adjustments had been properly made for the full amount which was overbanked and that there were two pending cases which may result in more refunds.

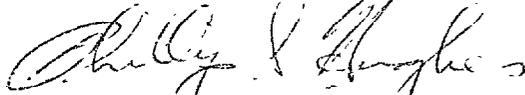
#### GULF'S OVERBANKING

Gulf overbanked \$119.7 million in increased crude oil costs between February and September 1974. None of these costs were passed through to the consumer.

On June 10, 1975, Gulf signed an agreement with FEA to decrease its bank for the total amount of overbanked costs. Our review showed that Gulf overbanked \$119.7 million and that, accordingly, the proper bank reduction was made.

We informally discussed the contents of this letter with FEA officials and a Gulf official, and they generally agreed with our findings.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Phillip S. Hughes".

Phillip S. Hughes  
Assistant Comptroller General