

**EXCERPT FROM 110<sup>th</sup> CONGRESS ACTIVITIES REPORT:  
ACTIVITIES OF THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**

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2d Session

SENATE

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111-360

ACTIVITIES OF THE COMMITTEE ON  
HOMELAND SECURITY AND  
GOVERNMENTAL AFFAIRS

REPORT

OF THE

COMMITTEE ON HOMELAND SECURITY AND  
GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE

AND ITS

SUBCOMMITTEES

FOR THE

**ONE HUNDRED TENTH CONGRESS**



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## PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

CHAIRMAN: CARL LEVIN

RANKING MINORITY MEMBER: TOM COBURN

The following is the Activities Report of the Permanent Subcommittee on Investigations during the 110th Congress:

### I. HISTORICAL BACKGROUND

#### A. SUBCOMMITTEE JURISDICTION

The Permanent Subcommittee on Investigations was originally authorized by Senate Resolution 189 on January 28, 1948. At its creation in 1948, the Subcommittee was part of the Committee on Expenditures in the Executive Departments. The Subcommittee's records and broad investigative jurisdiction over government operations and national security issues, however, actually antedate its creation, since it was given custody of the jurisdiction of the former Special Committee to Investigate the National Defense Program (the so-called "War Investigating Committee" or "Truman Committee"), chaired by Senator Harry S Truman during the Second World War. Today, the Subcommittee is part of the Committee on Homeland Security and Governmental Affairs.<sup>1</sup>

The Subcommittee has had 10 Chairmen: Senators Homer Ferguson of Michigan (1948), Clyde R. Hoey of North Carolina (1949–1952), Joseph R. McCarthy of Wisconsin (1953–1954), John L. McClellan of Arkansas (1955–1972), Henry M. Jackson of Washington (1973–1978), Sam Nunn of Georgia (1979–1980 and 1987–1994), William V. Roth of Delaware (1981–1986 and 1995–1996), Susan M. Collins of Maine (1997–2001); Carl Levin of Michigan (2001–2002); and Norm Coleman of Minnesota (2003–present).

Until 1957, the Subcommittee's jurisdiction focused principally on waste, inefficiency, impropriety, and illegality in government operations. Its jurisdiction has expanded considerably since then, however, today encompassing investigations within the broad ambit of the parent committee's responsibility for matters relating to the efficiency and economy of operations of all branches of the government, including matters related to: (a) waste, fraud, abuse, malfeasance, and unethical practices in government contracting and operations; (b) criminality or improper practices in labor-management relations; (c) organized criminal activities affecting interstate or international commerce; (d) criminal activity affecting the national health, welfare, or safety, including investment fraud,

<sup>1</sup>In 1952, the parent committee's name was changed to the Committee on Government Operations. It was changed again in early 1977, to the Committee on Governmental Affairs, and again in 2005, to the Committee on Homeland Security and Governmental Affairs, its present title.

commodity and securities fraud, computer fraud, and use of offshore banking and corporate facilities to carry out criminal objectives; (e) the effectiveness of present national security methods, staffing and procedures, and U.S. relationships with international organizations concerned with national security; (f) energy shortages, energy pricing, management of government-owned or controlled energy supplies; and relationships with oil producing and consuming countries; and (g) the operations and management of Federal regulatory policies and programs. While technically reduced to a subcommittee of a standing committee, the Subcommittee has long exercised its authority on an independent basis, selecting its own staff, issuing its own subpoenas, and determining its own investigatory agenda.

The Subcommittee acquired its sweeping jurisdiction in several successive stages. In 1957—based on information developed by the Subcommittee—the Senate passed a Resolution establishing a Select Committee on Improper Activities in the Labor or Management Field. Chaired by Senator McClellan, who also chaired the Subcommittee at that time, the Select Committee was composed of eight Senators—four of whom were drawn from the Subcommittee on Investigations and four from the Committee on Labor and Public Welfare. The Select Committee operated for 3 years, sharing office space, personnel, and other facilities with the Permanent Subcommittee. Upon its expiration in early 1960, the Select Committee's jurisdiction and files were transferred to the Subcommittee on Investigations, greatly enlarging the latter body's investigative authority in the labor-management area.

The Subcommittee's jurisdiction expanded further during the 1960s and 1970s. In 1961, for example, it received authority to make inquiries into matters pertaining to organized crime and, in 1963, held the famous Valachi hearings described below, examining the inner workings of the Italian Mafia. In 1967, following a summer of riots and other civil disturbances, the Senate approved a Resolution directing the Subcommittee to investigate the causes of this disorder and to recommend corrective action. In January 1973, the Subcommittee acquired its national security mandate when it merged with the National Security Subcommittee. With this merger, the Subcommittee's jurisdiction was broadened to include inquiries concerning the adequacy of national security staffing and procedures, relations with international organizations, technology transfer issues, and related matters. In 1974, in reaction to the gasoline shortages precipitated by the Arab-Israeli war of October 1973, the Subcommittee acquired jurisdiction to investigate government operations involving the control and management of energy resources and supplies.

In 1997, the full Committee on Governmental Affairs was charged by the Senate to conduct a special examination into illegal or improper activities in connection with Federal election campaigns during the 1996 election cycle. The Permanent Subcommittee provided substantial resources and assistance to this investigation, contributing to a greater public understanding of what happened, to subsequent criminal and civil legal actions taken against wrongdoers, and to enactment of campaign finance reforms in 2001.

## B. PAST INVESTIGATIONS

Armed with its broad jurisdictional mandate, the Subcommittee has in recent years conducted investigations into a wide variety of topics of public concern, ranging from corporate misconduct, including the Senate's most in-depth investigation of the collapse of the Enron Corporation, to unfair energy prices, predatory lending, and tax evasion. The Subcommittee has also conducted investigations into numerous aspects of criminal wrongdoing, including money laundering, the narcotics trade, child pornography, labor racketeering, and organized crime activities. In addition, the Subcommittee has investigated a wide range of allegations of waste, fraud, and abuse in government programs and consumer protection issues, addressing problems ranging from food safety to Medicare fraud to mortgage "flipping."

Most recently, under the leadership of Senator Coleman, the Subcommittee has focused on exposing corruption problems in the United Nations' Oil-for-Food Program, port and supply-chain security, credit counseling abuses, and Federal contractors with billions of dollars in unpaid taxes. At Senator Levin's request, the Subcommittee has also examined offshore tax abuses, the role of tax professionals in promoting abusive tax shelters, transparency and pricing problems in U.S. crude oil markets, abusive credit card practices, and the failure of U.S. bank regulators to crack down on possible money laundering practices at financial institutions like Riggs Bank.

In 1998, the Subcommittee marked the 50th anniversary of the Truman Committee's conversion into a permanent subcommittee of the U.S. Senate.<sup>2</sup> In the half-century of its existence, the Subcommittee's many successes have made clear to the Senate the importance of retaining a standing investigatory body devoted to keeping government not only efficient and effective, but also honest and accountable.

*(1) Historical Highlights*

The Subcommittee's investigatory record as a permanent Senate body began under the Chairmanship of Republican Senator Homer Ferguson and his Chief Counsel (and future Attorney General and Secretary of State) William P. Rogers, as the Subcommittee inherited the Truman Committee's role in investigating fraud, waste and abuse in U.S. Government operations. This investigative work became particularly colorful under the chairmanship of Senator Clyde Hoey, a North Carolina Democrat who took the chair from Senator Ferguson after the 1948 elections. The last U.S. Senator to wear a long frock coat and wing-tipped collar, Mr. Hoey was a distinguished southern gentleman of the old school. Under his leadership, the Subcommittee won national attention for its investigation of the so-called "five percenters," notorious Washington lobbyists

<sup>2</sup>This anniversary also marked the first date upon which internal Subcommittee records generally began to become available to the public. Unlike most standing committees of the Senate whose previously unpublished records open after a period of 20 years has elapsed, the Permanent Subcommittee on Investigations, as an investigatory body, may close its records for 50 years to protect personal privacy and the integrity of the investigatory process. With this 50th anniversary, the Subcommittee's earliest records, housed in the Center for Legislative Archives at the National Archives and Records Administration, began to open seriatim. The records of the predecessor committee—the Truman Committee—were opened by Senator Nunn in 1980.

who charged their clients 5 percent of the profits from any Federal contracts they obtained on the client's behalf. Given the Subcommittee's jurisdictional inheritance from the Truman Committee, it is perhaps ironic that the "five percenters" investigation raised allegations of bribery and influence-peddling that reached right into the White House and implicated members of President Harry Truman's staff. In any event, the fledgling Subcommittee was off to a rapid start.

What began colorful soon became contentious. When Republicans returned to the Majority in the Senate in 1953, Wisconsin's junior Senator, Joseph R. McCarthy, became the Subcommittee's Chairman. Two years earlier, as Ranking Minority Member, Senator McCarthy had arranged for another Republican Senator, Margaret Chase Smith of Maine, to be removed from the Subcommittee. Senator Smith's offense, in Senator McCarthy's eyes, was her issuance of a "Declaration of Conscience" repudiating those who made unfounded charges and used character assassination against their political opponents. Although Senator Smith had carefully declined to name any specific offender, her remarks were universally recognized as criticism of Senator McCarthy's accusations that communists had infiltrated the State Department and other government agencies. Senator McCarthy retaliated by engineering Senator Smith's removal from the Subcommittee, replacing her with the newly-elected Senator from California, Richard M. Nixon.

Upon becoming Subcommittee Chairman, Senator McCarthy staged a series of highly publicized anti-communist investigations, culminating in an inquiry into communism within the U.S. Army, which became known as the Army-McCarthy hearings. During the latter portion of these hearings, in which the parent Committee examined the Wisconsin Senator's attacks on the Army, Senator McCarthy recused himself, leaving South Dakota Senator Karl Mundt to serve as Acting Chairman of the Subcommittee. Gavel-to-gavel television coverage of the hearings helped turn the tide against Senator McCarthy by raising public concern about his treatment of witnesses and cavalier use of evidence. In December 1954, in fact, the Senate censured Senator McCarthy for unbecoming conduct; in the following year, the Subcommittee adopted new rules of procedure that better protected the rights of witnesses. The Subcommittee also strengthened the rules ensuring the right of both parties on the Subcommittee to appoint staff, initiate and approve investigations, and review all information in the Subcommittee's possession.

In 1955, Senator John McClellan of Arkansas began 18 years of service as Chairman of the Permanent Subcommittee on Investigations. Senator McClellan appointed the young Robert F. Kennedy as the Subcommittee's Chief Counsel. That same year, Members of the Subcommittee were joined by Members of the Senate Labor and Public Welfare Committee on a special committee to investigate labor racketeering. Chaired by Senator McClellan and staffed by Robert Kennedy and other Subcommittee staff members, this special committee directed much of its attention to criminal influence over the Teamsters Union, most famously calling Teamsters' leaders Dave Beck and Jimmy Hoffa to testify. The televised hearings of the special committee also introduced Senators Barry Goldwater



and John F. Kennedy to the Nation, as well as leading to passage of the Landrum-Griffin Labor Act.

After the special committee completed its work, the Permanent Subcommittee on Investigations continued to investigate organized crime. In 1962, the Subcommittee held hearings during which Joseph Valachi outlined the activities of La Cosa Nostra, or the Mafia. Former Subcommittee staffer Robert Kennedy—who had by now become Attorney General in his brother’s Administration—used this information to prosecute prominent mob leaders and their accomplices. The Subcommittee’s investigations also led to passage of major legislation against organized crime, most notably the Racketeer Influenced and Corrupt Organizations (RICO) provision of the Crime Control Act of 1970. Under Chairman McClellan, the Subcommittee also investigated fraud in the purchase of military uniforms, corruption in the Department of Agriculture’s grain storage program, securities fraud, and civil disorders and acts of terrorism. From 1962 to 1970, the Permanent Subcommittee on Investigations conducted an extensive probe of political interference in the awarding of government contracts for the Pentagon’s ill-fated TFX (“tactical fighter, experimental”). In 1968, the Subcommittee also examined charges of corruption in U.S. servicemen’s clubs in Vietnam and elsewhere around the world.

In 1973, Senator Henry “Scoop” Jackson, a Democrat from Washington State, replaced Senator McClellan as the Subcommittee’s Chairman. During these years, recalled Chief Clerk Ruth Young Watt—who served in that position from the Subcommittee’s founding until her retirement in 1979—Ranking Minority Member Charles Percy, an Illinois Republican, was more active on the Committee than Chairman Jackson, who was often distracted by his Chairmanship of the Interior Committee and his active role on the Armed Services Committee.<sup>3</sup> Senator Percy worked closely in this regard with Georgia Democrat Sam Nunn, who subsequently succeeded Senator Jackson as Chairman in 1979. As Chairman, Senator Nunn continued the Subcommittee’s investigations into the role of organized crime in labor-management relations and also investigated pension frauds.

The regular reversals of political fortunes in the Senate of the 1980s and 1990s saw Senator Nunn trade chairmanship three times with Delaware Republican William Roth. Senator Nunn served from 1979 to 1980 and again from 1987 to 1995, while Senator Roth served from 1981 to 1986, and again from 1995 to 1996. These 15 years saw a strengthening of the Subcommittee’s bipartisan tradition in which investigations were initiated by either the Majority or Minority and fully supported by the entire Subcommittee. For his part, Senator Roth led a wide range of investigations into commodity investment fraud, offshore banking schemes, money laundering, and child pornography. Senator Nunn led inquiries into Federal drug policy, the global spread of chemical and biological weapons, abuses in Federal student aid programs, computer security, airline safety, and health care fraud. Senator

<sup>3</sup>It had not been uncommon in the Subcommittee’s history for the Chairman and Ranking Minority Member to work together closely despite their partisan differences, but Senator Percy was unusually active in the Minority—a role that included chairing one investigation of the hearing aid industry.



Nunn also appointed the Subcommittee's first female counsel, Eleanor Hill, who served as Chief Counsel to the Minority from 1982 to 1986 and then as Chief Counsel from 1987 to 1995. Ms. Hill subsequently served as Inspector General at the Department of Defense.

*(2) Recent Investigations*

In January 1997, Republican Senator Susan Collins of Maine, became the first woman to Chair the Permanent Subcommittee on Investigations. Senator John Glenn of Ohio became the Ranking Minority Member. After Senator Glenn's retirement, Michigan Democrat Carl Levin succeeded him in January 1999, as the Ranking Minority Member. During Senator Collins' chairmanship, the Subcommittee conducted a number of investigations affecting Americans in their day-to-day lives, including investigations into mortgage fraud, phony credentials obtained through the Internet, deceptive mailings and sweepstakes promotions, day trading of securities, and securities fraud on the Internet. Senator Levin, while Ranking Minority Member, initiated an investigation into money laundering. At his request, the Subcommittee held hearings in 1999 on money laundering issues affecting private banking services provided to wealthy individuals, and in 2001 on how major U.S. banks providing correspondent accounts to offshore banks were being used to advance money laundering and other criminal schemes. Senator Collins chaired the Subcommittee until June 2001, when the Senate Majority party changed hands, and Senator Levin assumed the chairmanship. Senator Collins, in turn, became the Ranking Minority Member.

During the 107th Congress, both Senator Collins and Senator Levin chaired the Subcommittee. In her 6 months chairing the Subcommittee at the start of the 107th Congress, Senator Collins held hearings examining issues related to cross border fraud, the improper operation of tissue banks, and Federal programs designed to fight diabetes. Over the following 18 months, Senator Levin led a bipartisan investigation into Enron Corporation, which had collapsed into bankruptcy just before he became Chairman. The Subcommittee reviewed over 2 million pages of documents, conducted more than 100 interviews, held four hearings, and issued three bipartisan reports on the role played by Enron's Board of Directors, Enron's use of tax shelters, and how major U.S. financial institutions had contributed to Enron's accounting deceptions, corporate abuses, and ultimate collapse. The Subcommittee's investigative work contributed to passage of the Sarbanes-Oxley Act which enacted accounting and corporate reforms in July 2002. Senator Levin also advanced the money laundering investigation initiated while he was Ranking Minority Member and opened new investigations into offshore tax abuses, border security, and the pricing of gasoline and other fuels.

In January 2003, at the start of the 108th Congress, Senator Collins became Chairman of the full Committee on Homeland Security and Governmental Affairs, and Republican Senator Norm Coleman of Minnesota became the Subcommittee Chairman. Over the next 2 years, Senator Coleman held 15 hearings on topics of national and global concern including illegal file sharing on peer-to-peer net-

works, abusive practices in the credit counseling industry, the dangers of purchasing pharmaceuticals over the Internet, Federal contractors with billions of dollars in unpaid taxes, SARS preparedness, border security, and how Saddam Hussein abused the United Nations Oil-for-Food Program. At the request of Senator Levin, then Ranking Minority Member, the Subcommittee examined how some U.S. accounting firms, banks, investment firms, and tax lawyers were designing, promoting, and implementing abusive tax shelters across the country; and how some U.S. financial institutions were failing to comply with anti-money laundering controls mandated by the Patriot Act, using as a case history Riggs Bank accounts involving Augusto Pinochet, former President of Chile, and Equatorial Guinea, an oil-rich country in Africa.

During the 110th Congress, Chairman Coleman held 13 hearings on a wide range of topics, including three additional hearings on abuses associated with the United Nation's Oil-for-Food Program, two hearings on Federal contractors who failed to pay billions of dollars in taxes, additional border security hearings focused on securing the global supply chain, two hearings on the Department of Defense (DOD) travel abuses, and two field hearings on consumers hurt by abusive tax refund loans or unfair energy pricing. At Senator Levin's request, the Subcommittee also held hearings on offshore tax abuses, which are responsible for \$100 billion in unpaid taxes each year, and on U.S. money laundering vulnerabilities due to the failure of the States to obtain ownership information for the 2 million companies formed within their jurisdictions each year.

In January 2007, Senator Levin once again became Subcommittee Chairman. During the 110th Congress, Senator Levin held 14 hearings on a wide range of topics, including two hearings on unfair credit card practices, a hearing on tax and accounting mismatches involving executive stock options, hearings on excessive speculation in the natural gas market and the crude oil market, and hearings on offshore tax abuses involving tax haven banks and non-U.S. persons ducking payment of U.S. taxes on U.S. stock dividends. At the request of Senator Coleman, then Ranking Minority Member, the Subcommittee also held hearings on Medicare and Medicaid health care providers who cheat on their taxes, the payment of Medicare claims tied to deceased doctors, abusive practices involving transit benefits, U.S. dirty bomb vulnerabilities, Federal payroll tax abuses, and problems involving the United Nations Development Program.

The following pages describe the Subcommittee's work during the 110th Congress.

## II. SUBCOMMITTEE HEARINGS DURING THE 110TH CONGRESS

### A. *Credit Card Practices: Fees, Interest Charges, and Grace Periods (March 7, 2007)*

The Subcommittee's first hearing in the 110th Congress focused on unfair credit card practices. Two years earlier, in 2005, Senator Levin had initiated a Subcommittee investigation into credit cards by asking the Government Accountability Office (GAO) to conduct a study of credit card finance charges and disclosures to consumers. In 2006, GAO released a 125-page report which, for the first time

in years, provided a detailed description of the various fees, interest rates, and disclosure practices associated with 28 popular credit cards at the six largest U.S. credit card issuers. On March 7, 2007 the Subcommittee held a hearing that focused on three fundamental credit card issues: fees, interest rates, and grace periods.

The Subcommittee investigation determined that credit card issuers imposed a wide range of fees on card holders, including annual fees, late fees, over-the-limit fees, balance transfer fees, foreign exchange fees, and fees charged for paying a credit card bill over the telephone. Those high fees were made worse by the industry practice of including all fees in a consumer's outstanding balance so that the fees incurred interest charges. In other words, card issuers charged interest not only on funds lent to a consumer, but also on any fees assessed to a credit card account.

The Subcommittee investigation also found that credit card issuers typically applied multiple interest rates to the same card, depending upon the circumstances. For example, the credit card industry typically used one interest rate for cash advances, another for regular purchases, a third for balance transfers, and if a cardholder paid late or exceeded a credit limit, the issuer often imposed a so-called penalty interest rate that could exceed 30 percent. These interest rates often varied over time, rising and falling with the prime rate. These multiple interest rates that changed over time made it nearly impossible for consumers to track their finance charges. In addition, when a consumer paid off a portion of a monthly balance, but not the entire amount owed, credit card issuers typically charged interest on the entire balance, including the portion paid on time.

The Subcommittee investigation found that although many consumers thought that all credit cards provided them with a grace period before interest is charged, in fact, most credit card issuers did not provide a grace period to cardholders unless they paid their credit card balances in full each month. If a consumer owed any balance on a card from the prior month, there was typically no grace period provided for new purchases.

The hearing presented testimony from two panels, representing credit cardholders and credit card issuers. The first panel heard from Wesley Wannemacher, a credit card user, and Alys Cohen, a staff attorney at the National Consumer Law Center. Mr. Wannemacher testified about his experiences with a credit card he had obtained in 2001, with a \$3,000 credit limit. He used the card to pay for expenses mostly related to his wedding, and charged a total of about \$3,200, exceeding the card's credit limit by \$200. He spent the next 6 years trying to pay off the debt, averaging payments of about \$1,000 per year. Evidence showed that, during those 6 years, he was charged about \$4,900 in interest, \$1,100 in late fees, and \$1,500 in over-the-limit fees. He was hit 47 times with over-the-limit fees, even though he went over the limit only 3 times and exceeded the limit by only \$200. He was also assessed interest rates as high as 30 percent. Altogether, the fees and the interest charges added up to \$7,500 which, on top of the original \$3,200 credit card debt, produced total charges to him of \$10,700. At the time of the hearing, he'd paid about \$6,300 on his \$3,200 debt, but still owed \$4,400. After Mr. Wannemacher agreed to tes-

tify before the Subcommittee, his credit card issuer, Chase Bank USA, forgave his entire outstanding debt.

Ms. Cohen testified that exorbitant interest rates and multiple fees charged to already overburdened consumers are a growing source of financial hardship for American families. Ms. Cohen identified a list of abusive credit card practices, including burdensome fees, penalty interest rates, universal default practices, unfair allocation of payments, late payment triggers, unfair subprime credit cards, and mandatory arbitration clauses. She described penalty interest rates that dramatically increased a card's interest rate, and that were sometimes imposed for a single occasion of exceeding a credit limit or for a payment that was one day late. She noted that these penalty rates were applied, not just to future credit card transactions, but also to existing balances, which constituted a retroactive, unilateral change in the terms of the credit card loan. Ms. Cohen also criticized the practice of universal default, in which credit card lenders impose penalty rates, not for any conduct affecting the consumer's credit card account, but for conduct applicable only to other creditors. Ms. Cohen recommended a number of reforms to end these and other abuses.

The second panel presented testimony from three leading credit card issuers: Bruce Hammonds, President of Bank of America Card Services; Richard Srednicki, CEO of Chase Bank USA; and Vikram Atal, Chairman and CEO of Citi Cards. Mr. Hammonds testified about how credit cards work and the benefits they provide. He testified that, under the current system, consumers are able to access money or shop anywhere in the world, merchants can sell merchandise to consumers they don't know or may never see, and transactions are processed safely and almost instantaneously. According to Mr. Hammonds, credit cards also help consumers build their credit histories, participate in reward programs, and obtain protection against transaction fraud and identity theft. Mr. Hammonds also testified that Bank of America prices its credit cards based upon four primary factors: competition, risk, return, and regulation. He explained that the risk of nonpayment was managed in three ways: by issuing cards to those who demonstrated the ability to repay, monitoring customers' behavior, and working with customers who are experiencing problems to give them opportunities to repay.

Mr. Srednicki from Chase began his testimony with an apology to Mr. Wannemacher. He stated that Chase has policies and procedures in place to identify customers like Mr. Wannemacher, who have fallen into debt and are finding it difficult to work their way out. According to Mr. Srednicki, Chase policies and procedures failed to help Mr. Wannemacher, and he regretted it. Mr. Srednicki testified that Chase believed his case was an exception and not the rule, and that it was caused by human error, which is why they forgave the debt. Mr. Srednicki also announced that, as a result of the Wannemacher case, Chase had changed its policy on over-the-limit fees for all of its 100 million credit card accounts, and would no longer charge more than three over-the-limit fees for a single instance of exceeding a credit limit.

Mr. Srednicki testified that consumers use credit cards to manage cash flow, out of convenience, for protection, and for the special

offers of credit cards. He explained that most of Chase customers fell into the industry categories of “super-prime” and “prime,” and were fully able to pay their credit card bills. According to Mr. Srednicki, Chase was taking proactive steps to help improve the clarity of information disclosed to clients, and that 92 percent of Chase customers began and ended the year with the same or a better interest rate. Mr. Srednicki also referenced the 2006 GAO report finding that the total annual and penalty fees were roughly the same in 2004 as they were in 1990, and that most bankruptcies occur—not as a result of credit card debt, but primarily as a result of “unforeseen adverse events such as job loss, divorce and uninsured illness.”

Mr. Atal testified that, at Citi Cards, customer satisfaction drove their revenues, because lost customers were difficult to replace. He announced at the hearing that, to better serve their customers, Citi Cards had decided to stop using “universal default” practices, and would no longer impose penalty interest rates for conduct that applied only to another creditor. Mr. Atal also announced that Citi Cards would eliminate from its credit card agreements the clause allowing it to raise credit card rates “at any time for any reason.” Mr. Atal also described other services Citi Cards provided to clients, including customer alerts, financial literacy and consumer credit education, security and protection, disclosures, and hardship assistance, in order to treat consumers fairly and communicate with them in a clear and understandable way.

After the hearing, in May 2007, Senator Levin introduced S. 1395, The Stop Unfair Practices in Credit Cards Act, in order to combat the credit card abuses identified at the hearing. In 2008, Senator Dodd introduced S. 3252, a Dodd-Levin credit card reform bill that incorporated most of the Levin bill as well as additional measures to stop credit card abuses.

*B. Medicare Doctors Who Cheat on Their Taxes and What Should Be Done About It (March 20, 2007)*

As part of the Subcommittee’s continuing investigation of Federal contractors who are tax-delinquent, the Subcommittee examined the extent to which physicians and other health care providers who receive Medicare payments from the Federal Government also have unpaid tax debt. In addition, the Subcommittee investigated why the Centers for Medicare and Medicaid Services (CMS) had failed to establish systems to screen payments to Medicare health care providers to identify recipients with outstanding tax debt and subject them to levies under the Federal Payment Levy Program (FPLP). The Subcommittee held a hearing on these issues on March 20, 2007.

At the hearing, GAO testified that more than 21,000 physicians, health professionals, and suppliers who received payments from the Medicare Part B Program during the first 9 months of 2005 owed more than \$1 billion in unpaid Federal taxes. GAO also reported that Medicare physicians owed \$33 million in unpaid child support, \$27 million in delinquent student loans, \$22 million in unpaid State taxes, and \$114 million that was owed to Federal agencies. These other types of debt were not being collected, because CMS is statutorily exempt from collecting non-tax debt.



GAO identified 40 specific instances of abusive or potentially criminal activity related to Medicare health care providers with unpaid taxes. These 40 cases included a physician who received more than \$100,000 in Medicare payments, while owing nearly \$1 million in back taxes; an ambulance company that received more than \$1 million, while owing nearly \$11 million in taxes; and a medical imaging company that received more than \$1 million, while owing nearly \$3 million in unpaid taxes.

GAO also noted that, 6 years earlier, CMS had been cited for not participating in the FPLP tax levy program in a July 2001 GAO report entitled, "Tax Administration: Millions of Dollars Could Be Collected If IRS Levied More Federal Payments," GAO-01-711. GAO testified that CMS had failed to take any steps over the subsequent 6 years to establish the required FPLP screening procedures.

IRS Commissioner Mark Everson then testified about the recent progress that has taken place in the FPLP program to increase the number of Federal payments screened for unpaid taxes. The overall result has been a dramatic increase in tax collections, which have more than tripled from \$89 million in fiscal year 2003, to \$299 million in fiscal year 2006. With respect to CMS payments to Medicare health care providers, Commissioner Everson stated that these payments were legally subject to levy, and that the Internal Revenue Service (IRS), Financial Management Service (FMS), and CMS had begun talks to evaluate the steps needed to include these payments in the FPLP.

FMS Commissioner Kenneth R. Papaj testified that all levy collections have continued to increase due to improvements in the FPLP program. These improvements have included an increase in the types of payments that are being levied, more frequent screening of payments, and improved information enabling FMS to target tax levies successfully. He also testified that the issue of how to include Medicare payments in the FPLP had been taken up by the Federal Contractor Tax Compliance Task Force comprised of staff from IRS, FMS and CMS.

Finally, Acting CMS Administrator Leslie V. Norwalk testified that CMS was in the process of implementing the HealthCare Integrated General Ledger Accounting System, which will simplify the Medicare payment process and make it feasible to impose levies under the FPLP. CMS expected to complete implementation of the new system in 2011.

To deepen understanding of the extent of the problem, the Subcommittee asked GAO to conduct an expanded review of Medicare health care providers with unpaid taxes. On June 13, 2008, the GAO released a report entitled, "Medicare: Thousands of Medicare Providers Abuse the Federal Tax System," GAO-08-618, which looked at an entire year of data from 2006 for health care providers in both the Medicare Part A and Part B Programs. Overall, GAO estimated that over 27,000 Medicare providers, or about 6 percent of all Medicare providers, had unpaid Federal taxes totaling over \$2 billion. GAO also found instances of abusive and criminal activity in a nonrepresentative sample of 25 Medicare health care providers, often involving established businesses that had failed to remit their payroll taxes. The GAO report determined that CMS

had no mechanism to prevent providers with substantial unpaid Federal taxes from becoming Medicare providers or receiving Medicare payments. In addition, because CMS was not participating in the FPLP, GAO estimated that the government had lost the opportunity to collect between \$50 and \$140 million in unpaid taxes from payments disbursed in 2006 alone.

As a result of the Subcommittee's investigation, legislation was included in the Medicare Improvements for Patients and Providers Act of 2008, Public Law 110-275, to require CMS, over a 4-year period, to establish tax levy procedures for all Medicare payments to health care providers. CMS was required to begin screening a portion of those Medicare payments in 2008, and to increase the payments subject to levy until 100 percent were screened for unpaid taxes.

*C. Transit Benefits: How Some Federal Employees Are Taking Uncle Sam For a Ride (April 24, 2007)*

At the request of Senator Coleman, the Subcommittee initiated an investigation into reports that federally subsidized transit benefits in the form of Metrocheks and Smartrip cards, which were designed to be used only by Federal employees riding mass transit, were being sold to third parties in potential violation of Federal regulations. On April 24, 2007, the Subcommittee held a hearing which disclosed that program abuses were occurring, and that internal controls to prevent such abuses were inadequate.

Less than 10 years ago, the Federal transit benefits program was established to encourage Federal employees to use public transportation, like subways and buses, for the purpose of reducing road congestion, air pollution, gasoline consumption, and U.S. dependence on foreign oil. Nationwide, the program distributes about \$250 million in Federal travel subsidies each year and encourages nearly 300,000 Federal employees to commute to work on mass transit systems, by supplying them with monthly benefits that can pay for subway tokens or bus passes. More than half of these employees work in the Nation's capital and supply nearly a third of the 1.1 million daily trips taken on the local subway system. By getting these workers off the roads and into mass transit, the Federal transit benefit program was intended not only to support public transportation, but also benefit other Americans by lessening pollution, gasoline consumption, and wear and tear on roads.

Federal employees using Metrocheks and Smartrip cards are required to certify under penalty of perjury that they will not sell or transfer their transit benefits to anyone else and that the amount received does not exceed their monthly commuting costs. No single Federal agency is responsible for overseeing the transit benefits program; instead, each participating Federal agency is responsible for ensuring that its own employees make proper use of the transit benefits received.

A GAO investigation undertaken at the request of the Subcommittee determined that a variety of fraudulent and abusive practices affecting transit benefits were taking place in the Washington, D.C. metropolitan area. GAO identified, for example, Federal employees who were selling their transit cards on the Internet; falsifying benefit applications to claim excess benefits; claiming



mass transit and parking benefits at the same time; distributing benefits to friends and family; and receiving benefits after leaving employment with the Federal Government. GAO identified specific Federal employees engaged in these practices and turned their cases over to their agency employers. GAO also found that these abuses occurred in part because Federal agencies lacked the necessary internal controls to detect and prevent abuses.

GAO testified at the hearing about its findings. Representatives of Federal agencies also testified. They generally admitted abuses were occurring, and that each participating agency bore the responsibility for implementing internal controls to prevent them. These witnesses included Linda J. Washington, Acting Assistant Secretary for Administration, Department of Transportation; Calvin Scovel III, Inspector General for the Department of Transportation; Michael L. Rhodes, Director of Washington Headquarters Services, Department of Defense (DOD); and Acting DOD Inspector General Thomas Gimble. The hearing also disclosed that six different inspectors general, including the DOD IG, had previously audited use of transit benefits and concluded that the program controls were inadequate.

In response to the hearing, the Transportation Department and other agencies agreed to tighten controls, consider specifying uniform application forms and internal controls across the country, and exercise better oversight of Federal transit benefits.

*D. Executive Stock Options: Should the Internal Revenue Service and Stockholders Be Given Different Information? (June 5, 2007)*

In 2007, the Subcommittee initiated an investigation into excessive executive pay and abusive practices involving compensation paid to U.S. corporate executives, including through stock options. In 2006, the average pay of chief executive officers (CEOs) at large U.S. public companies was \$15.2 million, of which nearly half, \$7.3 million, came from exercising stock options. In 2006, CEOs received nearly 400 times the average pay earned by workers, and stock options were a key reason.

On June 5, 2007, the Subcommittee held a hearing examining how current U.S. accounting and tax rules require stock option compensation expenses to be valued in different ways on corporate financial statements compared to corporate tax returns, and how, in most cases, corporations take stock option tax deductions that are far in excess of the stock option expenses recorded on their financial statements. Stock option compensation is currently the only type of compensation in which corporations are allowed to take tax deductions that exceed their book expenses. The Subcommittee investigation found that, by providing overly generous stock option tax deductions, Federal tax policy encouraged corporations to provide excessive stock option pay, fueled the pay gap between executives and workers, and enabled profitable corporations to avoid paying billions in taxes.

At the hearing, the Subcommittee detailed the stock option book-tax difference at nine Fortune 500 companies. The data showed that the nine companies alone produced \$1 billion more in tax deductions than the expenses shown on their books, even after using

a new accounting rule requiring stock option compensation to be expensed on corporate financial statements.

Three of the nine companies testified at the hearing: Stephen F. Bollenbach, Chairman of the Board of Directors of KB Home, a residential construction company; John S. Chalsty, Chairman of the Compensation Committee of Occidental Petroleum Corporation, an oil company; and William Y. Tauscher, Member and former Chairman of the Compensation Committee of Safeway, Inc., a large grocery chain. The data showed that KB Home had claimed a \$143 million tax deduction for stock option expenses that, under the new accounting rule, would have totaled \$11.5 million, with the result that its tax deduction was 12 times bigger than its book expense. The data showed that Occidental Petroleum claimed a \$353 million tax deduction for a stock option book expense that, under the new accounting rule, would have totaled just \$29 million, a book-tax difference of more than 1,200 percent. The data also showed that Safeway claimed a \$39 million tax deduction for a stock option book expense that would have totaled about \$6.5 million, a difference of more than 600 percent. Altogether, the data showed that the nine companies took stock option tax deductions totaling \$1.2 billion, a figure five times larger than their combined stock option book expenses of \$217 million. The corporate witnesses did not dispute these figures; instead, they explained that their corporations had simply complied with the required accounting and tax rules which are responsible for producing these disparate results.

The second panel at the hearing presented testimony from government witnesses. Kevin M. Brown, Acting IRS Commissioner, presented a data analysis performed by the IRS at the request of the Subcommittee on the overall size and composition of the stock option book-tax difference. Using actual tax return information from schedules filed over 7 months from December 31, 2004 to June 30, 2005, Mr. Brown reported that about 3,000 companies had disclosed a book-tax difference related to stock option compensation, and overall, these companies had claimed \$43 billion more in stock option tax deductions than book expenses. He also reported that approximately 250 companies accounted for 82 percent of the \$43 billion in excess tax deductions. John W. White, Director of the Division of Corporation Finance of the U.S. Securities and Exchange Commission (SEC) testified that the dramatic growth of stock options as compensation was accompanied by abuses and deserved additional disclosure and transparency.

In the last panel, three experts discussed the stock option book-tax difference. Lynn E. Turner, former SEC Chief Accountant, testified about how the disparity in U.S. accounting and tax rules had created an incentive for companies to maximize stock options in order to benefit from the income tax deductions while also minimizing expenses for financial reporting purposes. He noted the conflicting information reported to investors and the SEC versus the IRS. Mihir A. Desai, an associate professor at the Harvard University Graduate School of Business Administration, testified that the dual reporting system created incentives for corporations to maximize the deductions reported to tax authorities, while minimizing the expenses reported to investors. He noted that investors did not have access to the information being given to tax authorities or to

the size of the book-tax discrepancy, which would help investors evaluate a company's actual economic performance. He also noted that the United States was an anomaly among its peers in its dependence on dual reporting, as most other countries have moved to align stock option tax and financial reporting without negative consequences. Finally, Jeff Mahoney, General Counsel to the Council of Institutional Investors, which represents corporate and union pension fund investors, testified that stock option compensation represented a true expense to corporations, that the existing policy encourages excessive stock option awards, and that it is simply bad tax policy to continue to allow profitable corporations to avoid payment of taxes by claiming large stock option tax deductions.

In 2008, at the request of the Subcommittee, the IRS updated its data to provide analysis for a full year of stock option book-tax differences. The IRS determined that, for tax returns filed in 2004, the amount by which corporate stock option tax deductions exceeded the equivalent book expenses was \$49 billion, up from the \$43 billion announced at the hearing. In addition, the IRS determined that the excess stock option tax deductions for corporate returns filed in 2005 totaled \$61 billion.

As a result of the Subcommittee investigation, on Sept. 28, 2007, Senator Levin introduced legislation, S. 2116, to require stock option tax deductions to match, and not exceed, a corporation's book expense.

*E. Excessive Speculation In The Natural Gas Market (June 25 and July 9, 2007)*

In June and July 2007, the Subcommittee held two days of hearings and released a 400-page bipartisan staff report which found excessive speculation in the natural gas market, using the case history of Amaranth Advisors LLC, a hedge fund which the report found had distorted 2006 U.S. natural gas prices through large speculative trades, traded in both regulated and unregulated energy commodity markets, and played each type of market off the other.

The Subcommittee investigation detailed the reasons for relatively high prices and volatility in the natural gas futures markets in 2006, and demonstrated how excessive speculation by a single hedge fund had dominated the natural gas market and distorted natural gas futures prices. The investigation also examined the extent to which speculative trading on unregulated energy exchanges had contributed to the price distortions. The report presented landmark evidence demonstrating for the first time that regulated and unregulated energy commodity markets affected each other's prices and U.S. energy costs.

The report also contained bipartisan recommendations to reduce excessive speculation in commodity markets, including by enacting legislation to close "the Enron loophole." The Enron loophole, inserted at the request of Enron and others into U.S. legislation that was enacted into law, exempts from government oversight any electronic commodity exchange whose trading is limited to large traders of energy or metals commodities, on the theory that large traders have no need for government safeguards. As a result of this exemption, one of the largest U.S. energy exchanges, the Interconti-

mental Exchange (ICE), has operated without government oversight or regulation since its inception, even after it has become clear that its trades affect prices on regulated markets like the New York Mercantile Exchange (NYMEX). The report recommended eliminating this statutory exemption from government oversight.

The first day of hearings, on June 25, presented three panels. On the first panel, three industry experts testified about the natural gas market: Arthur Corbin, President and CEO of the Municipal Gas Authority of Georgia, who testified on behalf of the American Public Gas Association; Paul N. Cicio, President of the Industrial Energy Consumers of America; and Sean Cota, President of the New England Fuel Institute. Each stated that Amaranth's large positions in the 2006 natural gas commodity markets had driven up natural gas prices beyond the levels of supply and demand, urged transparency in the unregulated over-the-counter energy markets, and advocated for enhanced authority for the Commodity Futures Trading Commission (CFTC) to prevent price manipulation and excessive speculation in energy markets. All three stated that U.S. energy prices were affected by trades in both the regulated commodity markets like NYMEX and unregulated electronic markets like ICE, and called for closing the Enron loophole.

The second panel presented testimony from two academic experts, Professor Vince Kaminski, Jesse H. Jones Graduate School of Management at Rice University; and Professor Michael Greenberger, University of Maryland School of Law. Both supported the findings in the Subcommittee staff report, including the recommendation to close the Enron loophole.

The final witness was Shane Lee, a former natural gas trader at Amaranth, who testified about Amaranth's natural gas trading practices. He admitted that the volume of Amaranth's trading was very large and took place in both regulated and unregulated markets, but disagreed that Amaranth's trading drove prices, and instead opined that the company merely responded to market forces. He supported extending reporting requirements and limits to unregulated exchanges.

On July 9, 2007, the Subcommittee held the second day of hearings, focused on the role of market regulators to protect the public from commodity price manipulation and excessive speculation. The first panel heard from Dr. James Newsome, President and CEO of NYMEX, and Jeffrey C. Sprecher, Chairman of the Board and CEO of ICE. Dr. Newsome testified that the existing statutory framework was unworkable, because of the regulatory disparity between CFTC's authority over NYMEX, but not ICE. Mr. Sprecher agreed with the Subcommittee recommendations to increase the CFTC budget and enhance its access to trading information, but disagreed that new legislation was needed to fill a regulatory gap. The final witness was the CFTC, represented by the Hon. Walter L. Lukken, Acting Chairman, and the Hon. Michael V. Dunn, Commissioner. They explained the limitations on CFTC regulatory authority, including with respect to exempt commercial markets such as ICE, the absence of over-the-counter reporting obligations, and the CFTC's difficulty in detecting fraud and manipulation.

In response to the Subcommittee's investigative work, on September 17, 2007, Senator Levin introduced S. 2058, the Close the

Enron Loophole Act. In May 2008, legislation based upon the Levin bill was included in the 2008 farm bill and effectively closed the Enron loophole and subjected electronic commodity markets that affect prices to CFTC regulation and oversight. In late July 2007, both the CFTC and the Federal Energy Regulatory Commission filed civil complaints against Amaranth and its head energy trader Brian Hunter for manipulating prices in the natural gas market.

*F. Dirty Bomb Vulnerabilities: Fake Companies, Fake Licenses, Real Consequences (July 12, 2007)*

As part of the Subcommittee's continuing examination of nuclear and radiological threats to the United States, the Subcommittee initiated an investigation into certain aspects of the materials licensing policies and procedures of the Nuclear Regulatory Commission (NRC). To evaluate the effectiveness of these policies and procedures, GAO, in response to a Subcommittee request, agreed to establish a false company and test whether the NRC's licensing procedures were sufficient to guard against the aggregation and misuse of relatively low-grade radioactive materials, including efforts to include these materials in a so-called "dirty bomb." On July 12, 2007, the Subcommittee held a hearing and issued a bipartisan staff report on the results of the GAO exercise, the process by which parties obtain NRC materials licenses, the vulnerability of NRC materials licenses to counterfeiting and fraud, and recommendations to strengthen NRC safeguards.

At the hearing, GAO was the first witness and testified about NRC licensing procedures and GAO's efforts to test those procedures. GAO explained that the NRC and certain "Agreement States" to which the NRC has delegated authority are responsible for regulating the possession and use of low-grade radiological materials within U.S. borders. GAO disclosed that the NRC and Agreement States use different licensing policies and procedures to issue about 1,000 new licenses each year allowing specified entities to possess and use certain radiological materials in a variety of medical and industrial fields.

GAO then described how it used aliases and a dummy corporation to apply simultaneously for two materials licenses—one through an Agreement State and one from the NRC. GAO testified that the Agreement State, as part of its licensing process, insisted on interviews with company officials and a physical tour of the company's facilities. Satisfied with the Agreement State's safeguards, GAO withdrew its application. GAO reported that, in contrast, the NRC opted not to conduct a site visit or in-person interviews with company officials as part of its licensing procedure. According to the GAO, in less than 30 days, after exchanging a handful of phone calls and faxes with GAO's sham corporate executives, the NRC issued a materials license to its dummy corporation allowing it to take possession of radiological materials.

GAO also testified that NRC materials licenses were singularly susceptible to counterfeiting. GAO described how, using off-the-shelf computer software, it electronically scanned the NRC license it had received and created a near-identical facsimile. Using the counterfeit license, GAO then contracted with two different companies to purchase a number of radiological devices. GAO testified



that the aggregate amount of radioactive materials that it had contracted to buy vastly exceeded the quantity authorized on the original NRC license, met the NRC's definition of a "dangerous" quantity, and could have been sufficient to construct a dirty bomb. GAO testified that it could have used the counterfeit NRC licenses to purchase virtually unlimited amounts of radioactive material. GAO offered a number of recommendations to strengthen NRC licensing procedures and combat counterfeit materials licenses.

On the second hearing panel, Edward McGaffigan, Jr., NRC Commissioner, acknowledged that GAO had revealed flaws in the NRC's licensing procedures for possession and use of low-grade radioactive materials. He noted that applicants for these materials do not undergo the same degree of scrutiny as applicants for more dangerous radioactive materials. For example, he acknowledged that, when reviewing applications for low-grade radioactive materials, NRC licensing officers were authorized to exercise judgment on whether pre-licensing site visits were necessary. Regarding the vulnerability of materials licenses to modification or counterfeiting, McGaffigan acknowledged that GAO's work provided "cause for concern."

In response to the Subcommittee's investigative work, the NRC proposed performing a retrospective examination of certain licenses issued by the NRC to verify that the licensees were legitimate; reevaluating NRC licensing procedures and guidance; examining options to combat counterfeit licenses; and reevaluating security measures. After the hearing, the NRC established an "Independent External Review Panel to Identify Vulnerabilities in the NRC's Materials Licensing Program," a "Materials Program Working Group," and a "Pre-Licensing Guidance Working Group." The Independent Review Panel and NRC staff embraced virtually all of the Subcommittee staff report's recommendations. Most notably, the NRC recognized the need to suspend its "good faith presumption" that new applicants seeking radioactive materials were honest and hasten implementation of a National Source Tracking System and a Web-Based Licensing System.

*G. Medicaid Providers That Cheat on Their Taxes and What Should Be Done About It (November 14, 2007)*

As part of the Subcommittee's continuing investigation into Federal contractors who are tax-delinquent, the Subcommittee examined the extent to which physicians and other health care providers who receive Medicaid payments from the 50 States, each payment of which includes some Federal funds, have unpaid Federal tax debt. As part of this investigation, the Subcommittee examined the complexity of the Medicaid payment system and how Medicaid payments could be screened to identify recipients with outstanding Federal tax debt and made subject to levies under the Federal Payment Levy Program (FPLP). The Subcommittee held a hearing on these issues on November 14, 2007.

At the request of the Subcommittee, GAO had initiated an evaluation of the unpaid Federal taxes owed by Medicaid health care providers. At the hearing, GAO testified that it had examined seven States accounting for 43 percent of Medicaid payments in FY 2006, and identified more than 30,000 providers, or about 5 percent

of the total, who owed more than \$1 billion in unpaid Federal taxes. GAO testified that more than half of the unpaid taxes were payroll taxes that employers had withheld from their employees and were required by law to remit to the Internal Revenue Service (IRS), but failed to do so. GAO estimated that, if the Federal Government had levied Medicaid payments in the seven selected States through the FPLP, it could have collected between \$70 and \$160 million in unpaid taxes.

GAO identified 25 specific instances of abusive or potentially criminal activity related to Medicaid health care providers with unpaid taxes. Those 25 cases included a nursing home facility that received more than \$39 million in Medicaid payments in FY 2006, while owing more than \$16 million in back taxes, primarily from unremitted payroll taxes; a hospital that received more than \$9 million from Medicaid, while owing nearly \$5 million in taxes; and a medical clinic that received nearly \$3 million, while owing nearly \$1 million in unpaid taxes.

GAO reported that, in addition to unpaid tax debt, Medicaid health care providers owed about \$31 million in unpaid child support, \$66 million in other Federal agency debt including delinquent student loans, and \$5 million in unpaid State taxes. GAO explained that these other types of debt were not being collected, because Medicaid payments are not processed through Federal payment systems.

The second hearing panel heard testimony from three Federal agencies: Linda Stiff, Acting IRS Commissioner; Kenneth R. Papaj, head of the Financial Management Service that operates the FPLP; and Dennis G. Smith, Director of the Center for Medicaid and State Operations at the Center for Medicare and Medicaid Services (CMS). Ms. Stiff and Mr. Papaj testified that Medicaid payments include both State and Federal components, are administered by the States under 50 different systems, and are currently not subject to the Federal Payment Levy Program (FPLP) because they are not considered "Federal payments." Mr. Smith described the procedures under which CMS makes quarterly payments to the States which, in turn, use those Federal funds in their Medicaid programs, including by making payments to health care providers. All three witnesses testified that incorporating Medicaid payments into the FPLP would be complex and difficult, and would likely require a change in law. They also pledged, as a result of the Subcommittee's investigative work, to examine the issues more closely.

In response to the Subcommittee's investigative work, in April 2008, Senators Coleman and Levin introduced S. 2843, the Medicaid Levy Enhancement Act, to authorize Federal tax levies on Medicaid payments to health care providers. The bill was referred to the Committee on Finance for further consideration.

#### *H. Credit Card Practices: Unfair Interest Rate Increases (December 4, 2007)*

On December 4, 2007 the Subcommittee held its second hearing of the year examining abusive credit card practices. The hearing focused on the problem of unfair interest rate increases, in particular the industry practice of increasing interest rates even for card holders who have paid their credit card bills on time, stayed below their



credit limits, and paid at least the minimum amount due. The hearing took testimony from both credit card holders and issuers.

The first panel took testimony from three consumers who described their experiences. Janet Hard of Freeland, Michigan, testified that, in 2006, Discover increased her credit card interest rate from 18 percent to 24 percent, even though she had made payments to Discover on time and paid at least the minimum amount due for over 2 years. Discover applied the 24 percent rate retroactively to her existing credit card debt of \$8,300, increasing her minimum payments and increasing the amount that went to finance charges instead of the principal debt. The result was that, despite making steady payments totaling \$2,400 over 12 months and keeping her purchases to less than \$100, Ms. Hard's credit card debt decreased by only \$350. According to Mrs. Hard, out of more than \$5,600 that she paid to Discover over a longer period of time, more than \$3,400 went solely to interest charges. Ms. Hard testified that the unilateral interest rate increase imposed on her by Discover, despite her record of on-time payments, had caused great hardship for her family.

Millard Glasshof of Milwaukee, Wisconsin, is a senior citizen on a fixed income. He testified that, for many years, he had made a \$119 monthly payment to Chase Bank to pay off a \$5,000 debt on a closed credit card account and was gradually reducing the amount owed. In December 2006, according to Mr. Glasshof, Chase suddenly increased his interest rate from 15 percent to 17 percent, and then hiked it again to 27 percent. He said that Chase applied the new 27 percent rate retroactively to his existing debt, which meant that, out of his \$119 payment, \$114 went to pay finance charges and only \$5 went to reducing his principal debt. Due to the new high interest rates as well as the imposition of excessive fees, Mr. Glasshof testified that, despite his making payments totaling \$1,300 over a 12-month period, his credit card debt did not go down at all.

Bonnie Rushing of Naples, Florida, described her experience with a Bank of America credit card that carried an interest rate of about 8 percent. She testified that, in April 2007, despite a history of timely payments on her credit card debt, Bank of America nearly tripled her interest rate to 23 percent. According to Ms. Rushing, she had received no prior notification of the rate hike. Ms. Rushing testified that a bank representative told her she had no recourse other than to accept the increased interest rate, pay off the account with another credit card, or try to renegotiate an interest rate higher than the prior 8 percent rate. Ms. Rushing testified that she asked to close the account and pay off the existing debt at the prior 8 percent rate, but was told it was not an option. Ms. Rushing testified that she closed the account and, after complaining to the Florida Attorney General, the Subcommittee, and her card sponsor, she was able to get Bank of America to restore the 8 percent rate she had been paying.

The second hearing panel heard from three leading credit card issuers: Bruce Hammonds, President of Bank of America Card Services; Roger Hochschild, President and Chief Operating Officer of Discover Financial Services; and Ryan Schneider, President for Card Services at Capital One. Mr. Hammonds described the bene-

fits that credit cards provide to consumers and the need to use risk-based pricing to ensure that credit is widely available and reduce costs for the least risky borrowers. Mr. Hammond testified that credit card issuers employ different risk-based pricing strategies, and consumers can make informed choices among them. Mr. Hochschild testified that Discover's ability to make risk-based and default-based price adjustments to annual percentage rates allows them to offer credit to a wider segment of the public, and price credit at a level appropriate for each borrower. According to Mr. Hochschild, many credit card users have seen the costs of credit come down. Mr. Hochschild testified that changes in interest rates occur for several reasons, including changes driven by a customer's payment behavior and changes reflecting credit costs and risks to an issuer's credit card portfolio.

Mr. Schneider testified that a flexible pricing structure is an essential tool in the safe and sound underwriting of open-ended, unsecured credit products. He testified that the ability to modify the terms of a credit card agreement to accommodate changes over time to the economy or the creditworthiness of consumers must be preserved as a matter of fiduciary responsibility. He testified that the consequences of imposing severe restrictions on the ability to reprice such loans in response to these changes could include significant reductions in the availability of credit to many and higher pricing for all, particularly for customers who pose a higher level of risk. Mr. Schneider testified that Capital One supported permitting consumers to reject a new interest rate in exchange for stopping the use of their card, and paying off their existing balance at their previous rate, and requiring a 45-day advance repricing notification.

In addition to the testimony of Ms. Hard, Mr. Glasshof, and Ms. Rushing, the hearing presented evidence that retroactive interest rate hikes on consumers with on-time payment histories were common in the credit card industry. Both Senator Levin's and Senator Dodd's credit card reform bills introduced in 2007 and 2008, as described earlier, included provisions to end this type of unfair credit card practice.

*I. Speculation In the Crude Oil Market (Joint Hearing, Permanent Subcommittee on Investigations and the Subcommittee on Energy of the Committee on Energy and Natural Resources) (December 11, 2007)*

In June 2006, the Subcommittee released a bipartisan staff report entitled, *The Role of Market Speculation In Rising Oil and Gas Prices: A Need To Put The Cop Back On The Beat*. It found that the traditional forces of supply and demand no longer fully accounted for rising prices and ongoing price volatility in the U.S. oil and gasoline markets. The report found that, in 2006, market speculation had also contributed to rising oil and gasoline prices, perhaps accounting for \$20 out of a \$70 barrel of oil. The report made a number of recommendations to increase market oversight and stop price manipulation and excessive speculation. In December 2007, the Subcommittee held a joint hearing with the Senate Subcommittee on Energy to examine further the reasons for rising U.S.

oil prices despite adequate U.S. supplies of oil, and the role of speculative trades in elevating energy prices.

The hearing focused on the role of speculators in driving up oil prices. Data was presented showing that, in recent years, the trading volume for oil futures contracts had increased dramatically, and the percentage of oil futures contracts held by speculators, as opposed to parties involved in the actual delivery of oil, had risen from approximately 15 percent to nearly 45 percent. Speculators were defined as traders seeking to profit from an increase in price as opposed to those seeking to hedge their position in order to assure a stable supply of oil at a set price. The hearing also examined evidence of the extent to which the Administration's policy for adding oil to the Strategic Petroleum Reserve (SPR), regardless of price, had contributed to rising oil prices by depleting market supplies. This issue had been explored in detail by the Subcommittee years earlier in a 2003 report prepared by Senator Levin's staff. In addition, the hearing looked at the disproportionate impact of sweet crude oil deliveries in Cushing, Oklahoma on U.S. oil prices overall. That particular type of sweet crude oil provides the benchmark price for U.S. crude oil in standard futures contracts on the New York Mercantile Exchange (NYMEX), which means that changes in its price can cause price swings across the entire U.S. oil market.

Four witnesses provided testimony about the likely cause of oil price increases. According to Guy F. Caruso, Administrator of the Energy Information Administration (EIA), research by EIA, CFTC, and other agencies indicated that recent oil price increases were caused by a confluence of multiple supply and demand factors: strong world economic growth, moderate supply growth from non-OPEC nations, OPEC production decisions, low spare production capacity, tight global commercial inventories, refining bottlenecks, and ongoing geopolitical risks. He discounted the role of speculative trades in producing rising oil prices.

The other three witnesses disagreed. Fadel Gheit, a Wall Street energy analyst, testified that, in his view, oil prices were inflated by as much as 100 percent from excessive speculation in the oil markets. He noted that this view was supported by the current Energy Secretary, most OPEC ministers, and the heads of major international oil companies. He urged regulation of oil trading to improve transparency, discourage excessive speculation, and prevent conflicts of interest by traders. Edward N. Krapels, Director of Financial Energy Market Services at Energy Security Analysis, Inc., concurred that financial speculators were driving up oil prices and that the government should respond by increasing disclosure and regulating the market. Dr. Philip K. Verleger, Jr., an oil expert and President of PK Verleger, LLC, likewise testified that speculation was responsible for driving up oil prices in commodity markets. He indicated that oil prices had also increased because of the increased demand fueled by the Administration's large purchase of sweet crude oil for the SPR.

In February 2008, Senator Levin joined Senator Dorgan and others in introducing legislation, S. 2598, to place a moratorium on purchases of high-priced oil for the SPR. A similar House bill, H.R. 6022, was enacted into law a few months later.

*J. United Nations Development Program: A Case Study of North Korea (January 24, 2008)*

In 2007, as part of an ongoing inquiry into management issues at the United Nations (UN), the Subcommittee commenced an examination into allegations of mismanagement and misconduct in the operations of the United Nations Development Program (UNDP) in the Democratic People's Republic of Korea (DPRK). Over the course of its investigation, the Subcommittee collected voluminous documents and interviewed dozens of individuals, including persons from the U.S. Mission to the United Nations, UNDP, other U.N. organizations, financial institutions, and the DPRK's Permanent Mission to the United Nations.

On January 24, 2008, the Subcommittee held a hearing and released a bipartisan staff report on its investigation. The report found that the UNDP had operated in North Korea with inappropriate staffing, questionable use of foreign currency instead of local currency, and insufficient administrative and fiscal controls. The report also showed how, in 2002, the DPRK government had used its relationship with the United Nations to execute deceptive financial transactions, moving over \$2.7 million of its own funds from Pyongyang to DPRK diplomatic missions abroad through a bank account intended to be used solely for UNDP activities and referencing UNDP in the wire transfer documentation. The report found that the UNDP also transferred U.N. funds to a company that, according to a letter from the U.S. State Department to UNDP, had ties to an entity involved in DPRK weapons activity. Additionally, the report found that, by preventing access to its audits and not submitting to the jurisdiction of the U.N. Ethics Office, the UNDP had impeded reasonable oversight and undermined its whistleblower protections.

The hearing heard from three panels of witnesses. The first panel featured the Hon. Zalmay Khalilzad, U.S. Ambassador to the United Nations, and the Hon. Mark Wallace, U.S. Ambassador to the United Nations for Management and Reform. The two ambassadors discussed a number of U.N. reform efforts, including establishment of the Independent Audit Advisory Committee (IAAC); extension of the U.N. ethics code to apply to the overall U.N. system, including U.N. Funds and Programmes; ongoing work by the U.N. Procurement Task Force; and the U.N. Transparency and Accountability Initiative (UNTAI) aimed at ensuring that Funds and Programme funds are delivered efficiently and effectively.

Both ambassadors discussed problems related to UNDP operations in North Korea. They noted that the UNDP operations had been shut down in March 2007, and a May 31, 2007 Board of Auditors preliminary inquiry had validated concerns that the UNDP acted in North Korea in violation of U.N. policies and rules by: (1) making payments in hard foreign currency; (2) utilizing staff provided by the North Korean government in core UNDP functions; and (3) failing to make adequate project site visits.

The second panel featured GAO which has conducted a number of studies over the years on issues related to the United Nations. GAO testified that recent events demonstrated the continuing need to reform and modernize the United Nations in such areas as management, ethics, procurement, and accountability. GAO attributed

the lack of progress in various budgetary, financial management, and administrative reforms to, in part, disagreements among member states about the priorities and importance of U.N. management reform efforts; the lack of comprehensive implementation plans for some management reform proposals; and administrative policies and procedures that complicate human resource reforms. GAO also testified that the governing bodies responsible for U.N. oversight, as well as member states, lacked full access to internal U.N. audit reports that identify and analyze critical issues.

The third panel featured four key U.N. officials: Frederick Tipson, Director of the UNDP Liaison Office; David Lockwood, Deputy Director of the UNDP Bureau for Asia and the Pacific; David Morrison, UNDP Director of Communications; and Robert Benson, Director of the U.N. Ethics Office. The Subcommittee acknowledged the privileges and immunities of the United Nations and expressed appreciation that the U.N. witnesses had voluntarily agreed to brief the Subcommittee. The UNDP officials discussed the UNDP operations in DPRK, noting that the North Korean development projects presented a host of management and administrative challenges. Mr. Tipson noted that, contrary to some allegations, the evidence showed that the UNDP had not transferred hundreds of millions of dollars in hard currency to the North Korean Government. He stated that the objective of the UNDP as an organization must be to satisfy the standards of their major government supporters, and that the organization was sufficiently transparent and accountable to provide confidence in its operations. He agreed, however, to communicate to UNDP management concerns about the existing restrictions on access to UNDP and other U.N. audit reports.

Mr. Benson briefed the Subcommittee on the establishment and jurisdiction of the U.N. Ethics Office of the United Nations Secretariat and its ability to review cases of retaliation against whistleblowers working at U.N. Funds and Programmes, such as UNDP. He noted that the U.N. Ethics Office had been established as a new and independent office within the U.N. Secretariat reporting directly to the Secretary-General. According to Mr. Benson, the new U.N. Ethics Office's jurisdiction was limited to the U.N. Secretariat, did not reach the U.N. Funds and Programmes, and could not protect UNDP whistleblowers. He noted that the heads of the U.N. Funds and Programmes had agreed to establish a single ethics code and oversight system, but that was outside his office.

*K. Medicare Vulnerabilities: Payments for Claims Tied to Deceased Doctors (July 9, 2008)*

As part of an ongoing investigation into waste, fraud, and abuse in the Medicare and Medicaid programs, on July 9, 2008, the Subcommittee held a hearing and released a bipartisan staff report on the payment by Medicare of durable medical equipment (DME) claims using identification numbers belonging to deceased physicians. Using Medicare data from 2000–2007, the report estimated that nearly half a million payments, totaling about \$76 million, had been provided to medical equipment suppliers submitting claims using the identification numbers of 17,000 deceased doctors, which is about half of the deceased doctor population.



For many years, Medicare had required all medical claims to include an identifier for the prescribing physician. The identifier, until recently, was called the Unique Physician Identification Number (UPIN). In 2001, the Inspector General (IG) of the U.S. Department of Health and Human Services (HHS) issued a report alerting the Centers for Medicare and Medicaid Services (CMS) to failures in the UPIN system after finding that, in 1999 alone, over \$90 million had been paid for medical equipment claims with invalid UPINs. In response, CMS instructed the contractors that maintained the UPIN registry to review the UPIN database, eliminate UPINs for deceased physicians, and keep the registry updated going forward. The contractors were also told to modify the claims process to bar payment of claims with invalid UPINs. CMS reported to the HHS IG that the needed UPIN reforms had been completed, but neither CMS nor its contractors ever tested them to ensure they worked. The Subcommittee's investigation showed that, despite the 2001 reform effort, CMS continued to pay millions of dollars of Medicare claims referencing deceased physicians.

The hearing took testimony from three agency officials about the problem: Herb Kuhn, CMS Deputy Administrator; Robert Vito, Regional HHS IG; and William E. Gray, Deputy Commissioner at the Social Security Administration (SSA). Mr. Vito discussed three consecutive HHS IG reports that had identified problems with inaccurate UPIN data, the most recent of which, in 2003, found that 52 percent of medical providers in the UPIN database had inaccurate information in at least one of the practice settings. Mr. Vito noted that CMS had decided to replace the UPIN system and was in the process of converting to a new National Provider Identifier (NPI) system, with stronger controls, including Social Security number verifications. He voiced concerns, however, that initial IG work had already identified invalid physician identifiers in the new NPI system and that additional studies were needed. Mr. Gray described SSA's procedures for providing death information to CMS on an electronic and automated systems, to facilitate contractor efforts to update the NPI system and remove identifiers for deceased physicians. Mr. Kuhn described CMS' efforts to ensure that invalid provider numbers are not used to perpetrate Medicare fraud, including its intent to work with the IG and SSA to ensure the NPI system was effective. CMS also committed to instituting software changes to bar payment of Medicare claims with invalid physician identifiers, and to testing those changes once they were in place to make sure they worked.

*L. Tax Haven Banks and U.S. Tax Compliance (July 17 and 25, 2008)*

Since 2001, the Subcommittee has devoted investigative resources to exposing tax haven and tax shelter abuses that are undermining the integrity of the Federal tax system, diverting tens of billions of dollars each year from the U.S. Treasury, and shifting the tax burden from high income corporations and individuals onto the middle class. The Subcommittee has determined that offshore tax abuses alone result in an estimated revenue loss of \$100 billion in unpaid taxes each year. In July 2008, the Subcommittee held two days of hearings and released a bipartisan staff report dem-

onstrating how two offshore banks, UBS and LGT, had facilitated tax dodging by U.S. taxpayers and used offshore secrecy laws to hide the actions of both their clients and their own personnel.

UBS AG is one of the largest financial institutions in the world, with headquarters in Switzerland and banking branches across the United States and other countries. LGT Bank is the leading private bank in Liechtenstein and is owned by the Liechtenstein royal family. The report released by the Subcommittee detailed how both banks opened accounts for U.S. clients and deliberately helped them hide assets, dodge taxes, and duck creditors and courts. At the hearing, UBS admitted helping over 19,000 U.S. taxpayers open Swiss bank accounts with about \$18 billion in assets that were not disclosed to the IRS. UBS promised to close those accounts and no longer offer Swiss accounts to U.S. taxpayers without notifying the IRS of the account openings. With respect to LGT, the report presented seven case histories of U.S. persons who opened LGT accounts and used the services of the bank and its affiliates to conceal assets and engage in tax evasion. The hearing also presented a list of some of the deceptive practices used by the two tax haven banks and offered recommendations to stop the abuses.

On the first day of hearings, a half dozen witnesses appeared before the Subcommittee. The opening panel took testimony from two U.S. Government officials involved in the fight against offshore tax abuse: Hon. Douglas H. Shulman, IRS Commissioner, and the Hon. Kevin O'Connor, Associate Attorney General at the U.S. Department of Justice (DOJ). Mr. Shulman discussed some of the tools used by the IRS to stop offshore tax evasion, including requests for information about foreign bank accounts made under tax treaties and tax information exchange agreements. He also discussed use of so-called "John Doe summons," which are summons that request information related to a class of U.S. taxpayers who may be violating tax laws but cannot be identified by name. Mr. O'Connor discussed DOJ's role in combating offshore tax evasion through civil and criminal tax cases. He described DOJ efforts to pursue professionals who help create and promote offshore tax evasion schemes, including tax attorneys, accountants, and bankers. He also described DOJ's use of tax treaties, tax information exchange agreements, and Mutual Legal Assistance Treaties to obtain evidence.

The hearing next accepted sworn testimony from Henrich Kieber, a former LGT employee who had provided over 12,000 pages of internal LGT documents detailing accounts opened by U.S. persons. Because Mr. Kieber was in a witness protection program, the Subcommittee presented a video recording of his statement. In it, he described some of the tactics used by LGT to help clients keep assets out of the reach of tax authorities, such as transferring funds through shell corporations or foundations in an effort to confuse audit trails tracing wire transfers; requiring LGT bankers to use pay phones to contact clients; using pre-established code words for clients or accounts; and retaining account statements in Liechtenstein.

On the next panel, two witnesses invoked their right to remain silent under the Fifth Amendment of the U.S. Constitution. The witnesses were Shannon Marsh, the son of a Florida construction



company owner who had opened accounts in the names of four Liechtenstein foundations with combined deposits of nearly \$50 million; and William Wu, a New York resident who established two Liechtenstein foundations at LGT, transferred substantial sums to them, and conducted a sham sale of his New York residence to an offshore company he secretly controlled. A third witness was Steven Greenfield, a New York toy importer with \$30 million in offshore funds that LGT sought to have transferred to an LGT account. Mr. Greenfield attempted to assert his Fifth Amendment rights at the hearing through a letter from his lawyer, but was instructed of his need to appear in person at a subsequent hearing. A fourth witness, Peter S. Lowy, a California resident associated with a \$68 million LGT account held in the name of a Liechtenstein foundation and the subject of a Subcommittee subpoena, also committed to appear at the later hearing.

The next witness was Martin Liechti, a Swiss citizen who was the head of UBS Wealth Management Americas in Switzerland and who had been detained in Florida for some weeks by DOJ as a material witness to UBS' activities in the United States. He had been subpoenaed by the Subcommittee to testify at the hearing, but also asserted his right to remain silent under the Fifth Amendment.

The final witness was Mark Branson, the Chief Financial Officer of UBS Global Wealth Management and Business Banking in Switzerland. As a Swiss citizen residing outside of the United States, Mr. Branson was not subject to the Subcommittee's subpoena authority and appeared on a voluntary basis. Mr. Branson began his statement with an apology on behalf of UBS for its compliance failures and committed the bank to operating in the United States within the law. He stated that UBS intended to close all Swiss accounts that had been opened for U.S. accountholders without alerting the IRS, and that UBS would no longer open such accounts. He testified that UBS was working with U.S. authorities to identify the names of the U.S. accountholders who may have been engaged in tax fraud.

The Subcommittee had also invited LGT to appear, but LGT was outside the reach of the Subcommittee's subpoena authority and chose not to attend the hearing.

A week later, on July 25, the Subcommittee reconvened the hearing to take testimony from the two witnesses who had not appeared in person on July 17: Steven Greenfield and Peter Lowy. Both made appearances and asserted their rights to remain silent under the Fifth Amendment.

*M. Payroll Tax Abuse: Businesses Owe Billions and What Needs To Be Done About It (July 29, 2008)*

Consistent with the Subcommittee's ongoing interest in exposing schemes involving tax evasion, on July 29, 2008, the Subcommittee held a hearing on the problem of unpaid payroll taxes. Payroll taxes require businesses to withhold certain amounts from employee paychecks and remit those amounts to the IRS to pay individual Social Security and Medicare taxes. Businesses are also required to remit employer matching amounts. At the hearing, the Subcommittee released a GAO report, *Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes* (GAO-08-617), which had

been prepared at the request of the Subcommittee and which found that over 1.6 million businesses owed in excess of \$58 billion in unpaid Federal payroll taxes.

At the hearing, the Subcommittee heard from two witnesses. The first witness was GAO which summarized its report. GAO stated that the total amount of unpaid payroll taxes had grown from \$49 billion in 1998, to \$59 billion in 2007, but estimated that more than half of the debt was uncollectible. GAO testified that much of the debt was attributable to repeat offenders, as the number of businesses with over 5 years of unpaid taxes had increased nearly three-fold, and the number with over 10 years of unpaid taxes had increased five-fold. GAO explained that, to collect the tax, the IRS had two primary enforcement tools, filing liens against the business and filing personal claims against the business' officers or owners, but often failed to utilize these tools in a timely or effective manner. GAO noted, for example, of the cases awaiting assignment to an IRS agent, 80 percent did not have a tax lien filed. In addition, of the individuals who were subject to a personal claim, 43 percent never made a payment. GAO noted that the failure to collect these payroll taxes gave tax-delinquent businesses a competitive advantage over honest companies, and also forced tax compliant taxpayers to pick up the tab.

The next witness was Linda Stiff, IRS Deputy Commissioner for Services and Enforcement. She discussed the IRS' enforcement efforts and future plans to collect payroll taxes. She noted the collections problems posed by old debt and by businesses that were bankrupt or out of business. She announced the agency's intention to establish a new task force to better focus enforcement efforts on payroll tax collection and launch new research efforts to identify cost effective enforcement strategies.

Senators Coleman and Levin made several recommendations to strengthen payroll tax collection. They included developing an expedited process to impose automatic tax liens and personal penalties against businesses and business officers who are repeat offenders; supporting the Levin-Coleman Tax Lien Simplification Act, S. 1124, to establish an electronic tax lien registry at the Federal level, which would save \$570 million over 10 years; and establishing performance metrics to measure payroll tax collection efforts.

*N. Dividend Tax Abuse: How Offshore Entities Dodge Taxes on U.S. Stock Dividends (September 11, 2008)*

In continuation of its efforts to combat offshore tax abuse, on September 11, 2008, the Subcommittee held a hearing and released a staff report on how major U.S. financial institutions have been helping offshore hedge funds and other non-U.S. persons dodge payment of U.S. taxes on U.S. stock dividends. The hearing showed how these financial institutions enabled their offshore clients to use complex derivative and stock loan transactions to recharacterize their taxable U.S. stock dividends as allegedly tax-free dividend equivalents or substitute dividend payments. According to the GAO, in 2003, \$42 billion in U.S. stock dividend payments were sent abroad, but less than 5 percent, or \$2 billion was paid as tax. The general tax rate for non-U.S. stockholders is 30 percent, unless

their country of residence has a lower negotiated rate with the United States, usually 15 percent, which indicates that billions of dollars in tax revenue were being lost each year due to dividend tax abuses. To illustrate how this was happening, the report presented six case histories of large U.S. financial institutions engaging in such “dividend enhancement” practices. In addition, the report showed that the offshore hedge funds benefiting from these practices were, in large part, offshore in name only, while their main offices, key decision makers, and investment professionals were located in the United States.

The hearing took testimony from four panels of witnesses. On the first panel, an international tax law expert, Professor Reuven S. Avi-Yonah from the University of Michigan School of Law, explained different dividend payment structures and how, despite the equivalent financial character among them, they are treated differently for tax purposes. He testified that, where there are multiple ways to achieve the same economic result, there is an open invitation for abuse by taxpayers to avoid taxation.

The next panel featured witnesses from three offshore hedge funds: Joseph M. Manogue, Treasurer of Maverick Capital, Ltd.; Richard Potapchuck, Director of Treasury and Finance at Highbridge Capital Management; and Gary Wolfe, Managing Director of Angelo, Gordon and Co. All three acknowledged that their hedge funds had engaged in derivative transactions and stock loans to avoid payment of U.S. stock dividend taxes. Mr. Manogue testified that Maverick Capital had engaged in tax-free dividend transactions until 2007, when the financial institutions with whom they did the transactions suspended them, because the IRS was reviewing their legitimacy. Mr. Potapchuck testified that if the 30 percent withholding tax were to be applied to U.S. stock dividends, it would likely diminish the volume of stock dividends paid to non-U.S. investors who would shift to other tax-free dividend-paying securities investments. Mr. Wolfe testified that the swap transactions were carried out to maximize returns for investors, and that the tax benefits associated with swaps for non-U.S. investors were a significant factor in evaluating the overall return. All three witnesses also acknowledged that their offshore hedge funds had no employees or physical offices in the Cayman Islands where they were registered, and instead had all of their key decisionmakers in the United States.

The next panel featured representatives from three large financial institutions engaged in tax-free dividend transactions with non-U.S. investors: John DeRosa, Managing Director and Global Tax Director at Lehman Brothers Inc.; Matthew Berke, Managing Director and Global Head of Equity Risk Management at Morgan Stanley and Co.; and Andrea Leung, Global Head of Synthetic Equity Finance at Deutsche Bank AG. All three testified that they believed their usage of swaps and stock loans that referenced dividend amounts was in compliance with U.S. tax laws. In their view, investors engaged in those transactions in order to gain leverage, obtain operational and other efficiencies, and execute strategies hidden from the scrutiny of competitors. Mr. Berke also acknowledged that the tax benefits were an attractive reason for engaging in the swap transactions.

The final panel took testimony from the Hon. Douglas H. Shulman, IRS Commissioner. Mr. Shulman acknowledged that the IRS had observed swaps and stock loan transactions that were not being conducted for bona fide business purposes, but failed to issue guidance or take strong enforcement actions. He noted that the IRS had recently initiated an extensive review of the transactions to identify and put an end to abusive practices. He also stated that IRS was working with the Treasury Department to review, and modify if necessary, IRS Notice 97-66, the primary guidance that permits investors to avoid withholding on the payment of dividends in certain securities lending deals, given that companies have been able to circumvent the original purpose of the notice.

### III. LEGISLATIVE ACTIVITIES DURING THE 110TH CONGRESS

The Permanent Subcommittee on Investigations does not have legislative authority, but because its investigations play an important role in bringing issues to the attention of Congress and the public, the Subcommittee's work frequently contributes to the development of significant legislative initiatives. The Subcommittee's activity during the 110th Congress was no exception, with Subcommittee hearings and Members playing prominent roles in the development of a number of legislative initiatives.

#### *A. Credit Card Accountability Responsibility and Disclosure Act (S. 3252)*

On May 15, 2007, Senator Levin introduced S. 1395, the Stop Unfair Practices in Credit Cards Act, to put an end to the credit card abuses examined during the Subcommittee's hearings. In 2008, Senator Chris Dodd, Chairman of the Committee on Banking, Housing, and Urban Affairs, joined with Sen. Levin and others to introduce an even stronger bill, S. 3252, the Credit Card Accountability Responsibility and Disclosure Act. This Dodd-Levin bill incorporated almost all of the provisions from the Levin bill and added additional provisions from an earlier Dodd bill, resulting in the strongest consumer protections of any credit card reform bill in Congress.

Among other provisions, the Dodd-Levin bill would prohibit interest charges on any portion of a credit card debt which the card holder paid on time during a grace period; prohibit interest rate hikes for cardholders who pay on time and meet their credit card obligations; require increased interest rates to apply only to future credit card debt, and not to debt incurred prior to the increase; prohibit the charging of interest on credit card transaction fees, such as late fees and over-the-limit fees; prohibit the charging of repeated over-the-limit fees for a single instance of exceeding a credit card limit; require card issuers to offer consumers the option of operating under a fixed credit limit that cannot be exceeded; prohibit charging a fee to allow a credit card holder to make a payment on a credit card debt, whether payment is by mail, telephone, electronic transfer, or otherwise; and require payments to be applied first to the credit card balance with the highest rate of interest, and in a manner that would minimize finance charges.

The bill was referred to the Banking Committee for further consideration.

*B. Stop Tax Haven Abuse Act (S. 681)*

On February 17, 2007, Senators Levin, Coleman, and Obama introduced the Stop Tax Haven Abuse Act, a comprehensive bill to eliminate offshore tax haven and tax shelter abuses. This legislation arises from Subcommittee's 4 years of investigation into offshore tax havens, abusive tax shelters, and the professionals who design, market, and implement these tax dodges. The loss to the Treasury from offshore tax evasion alone approaches an estimated \$100 billion per year, including \$40 to \$70 billion from individuals and another \$30 to \$50 billion from corporations engaging in offshore tax evasion.

Among other measures, the bill would strengthen penalties on tax shelter promoters; authorize the Treasury to take special measures against foreign jurisdictions and financial institutions that impede U.S. tax enforcement; establish rebuttable presumptions in tax enforcement cases that offshore companies and trusts are controlled by the U.S. persons who send or receive assets from them; and stop offshore trusts from claiming they can buy jewelry, artwork, or real estate for use by U.S. beneficiaries on a tax-free basis. It would also strengthen detection of offshore misconduct by requiring U.S. financial institutions to report certain offshore activities to the IRS; and require hedge funds and company formation agents to understand the identity of their offshore clients and report suspicious activity to U.S. law enforcement.

In addition, Section 303 of the bill marked the first time that legislation had been introduced in Congress to prohibit the U.S. Patent and Trademark Office from issuing patents for "inventions" to avoid taxes. The Patent Office has already issued numerous tax patents, and is considering hundreds more. Unscrupulous tax shelter promoters could claim a patent represents an official endorsement of an abusive tax product and use the patent to generate income. Tax patents issued for legitimate tax avoidance strategies could require taxpayers to pay a royalty fee to minimize their taxes, even though all persons ought to be able to use legal means to reduce their tax burden. Companies could even patent a legal method to minimize taxes and refuse to license the patent to competitors in order to prevent them from lowering their operating costs. Such tax patents could end up hindering productivity and competition. A companion bill was introduced in the House (H.R. 2136), and a prior bill was introduced in the last Congress (S. 2210). The bill was referred to the Senate Finance Committee for further consideration.

*C. Tax Lien Simplification Act (S. 1124)*

On April 17, 2007, Senators Levin and Coleman introduced S. 1124, the Tax Lien Simplification Act, to simplify and modernize the Federal tax lien system. The bill would create an electronic Federal tax lien registry on the Internet, available to the public at no cost, replacing the current antiquated system requiring Federal tax liens to be filed on paper in more than 4,000 locations across the country. According to the IRS, moving to this electronic registry would save taxpayers an estimated \$570 million over 10 years.

Tax liens are the principal means used by the IRS to collect funds from tax delinquents. Tax lien notices must be made public,



and current law requires the IRS to file public notices on paper in more than 4,000 local recording offices, each with its own formatting requirements. An electronic national tax lien registry would simplify and standardize the filing process, reduce the incidence of lost and misfiled tax liens, make it easier for taxpayers to review their liens and fix errors, reduce staffing needs, allow the public to search the registry through the Internet at no cost, and enable the IRS to eliminate tax liens more quickly once they are paid. The bill would give the Treasury 2 years to establish the registry, but also allow continued use of the old system during a transition period.

The bill was referred to the Finance Committee for further consideration.

*D. The Medicare Improvements for Patients and Providers Act (Public Law 110-275)*

In response to a 2007 Subcommittee hearing revealing that over 30,000 Medicare health care service providers owed unpaid taxes exceeding \$1 billion, on May, 3, 2007, Senators Coleman and Levin introduced S. 1307, the Medicare Provider Accountability Act. The Subcommittee hearing disclosed that, despite a legal requirement to do so, the Federal Government's lead agency in the Medicare program, the Centers for Medicare and Medicaid Services (CMS), had failed to subject Medicare payments to the Federal Payment Levy Program, which screens Federal payments and, if the recipient is tax-delinquent, takes a portion of the payment to reduce the recipient's outstanding tax debt. The Coleman-Levin bill sought to require CMS to meet certain deadlines for bringing Medicare payments into the levy program.

In 2008, Congress enacted the Medicare Improvements for Patients and Providers Act to avert a payment reduction to physicians in Medicare. To help pay for the costs of this legislation, the bill included a provision based upon the Coleman-Levin bill. The enacted law requires Medicare, over a 4-year period, to establish systems to apply the tax levy program to all Medicare payments, screen those payments to determine whether the recipients owe U.S. taxes, and retain a portion of the payments to be applied to recipients' outstanding tax debt. The resulting tax levies are expected to produce at least \$335 million in tax revenues over 10 years.

*E. Medicaid Levy Enhancement Act (S. 2843)*

On April 10, 2008, in response to a November 2007 Subcommittee hearing revealing that over 30,000 Medicaid health care providers owed more than \$1 billion in unpaid Federal taxes, Senators Coleman and Levin introduced S. 2843, the Medicaid Levy Enhancement Act.

The Subcommittee hearing disclosed that Medicaid payments, which contain a mixture of Federal and State dollars, are currently not subject to the Federal Payment Levy Program which screens Federal payments and, if the recipient is tax-delinquent, takes a portion of the payment to reduce the recipient's outstanding Federal tax debt. At the hearing, GAO testified that if tax levies had been applied to Medicaid payments in the seven States reviewed

for the Subcommittee, the Federal Government could have collected between \$70 and \$160 million in unpaid taxes in 2006 alone.

The Coleman-Levin bill would amend the Federal tax levy law to authorize tax levies on Medicaid payments to health care providers. The bill was referred to the Committee on Finance for further consideration.

*F. Ending Corporate Tax Favors For Stock Options Act (S. 2116)*

On September 28, 2007, after a Subcommittee investigation and hearing showing that, each year, corporations are claiming tens of billions of dollars in stock option tax deductions in excess of the stock option expenses shown on their books, Senator Levin introduced S. 2116, the Ending Corporate Tax Favors For Stock Options Act, to limit stock option tax deductions to the amounts recorded on company books as an expense.

The bill would amend Section 83 of the tax code to require that corporate tax deductions for stock option compensation match, and not exceed, the stock option expenses shown on a corporation's financial statements. It would allow corporations to deduct stock option compensation in the same year it is recorded on the company books, without waiting for the options to be exercised; ensure research tax credits use the same stock option deduction when computing the "wages" eligible for that tax credit; and create a transition rule to phase in the new tax treatment. The bill would also eliminate favored treatment of corporate stock options under Section 162(m) of the tax code by making executive stock option deductions subject to that section's existing \$1 million cap on allowable corporate tax deductions for compensation paid to the top executives of publicly held corporations.

The bill was referred to the Finance Committee for further consideration.

*G. Close the Enron Loophole Act (S. 2058) and 2008 Farm Bill (Public Law 110-246)*

On September 17, 2007, Senator Levin introduced S. 2058, the Close the Enron Loophole Act, to eliminate an existing statutory provision that bars government regulation and oversight of key energy commodity exchanges. The legislation was a response to a Subcommittee investigation showing that commodity trades on unregulated markets like the Intercontinental Exchange (ICE) were affecting energy prices on regulated markets like the New York Mercantile Exchange (NYMEX), and that the lack of oversight invited price manipulation, excessive speculation, and inflated energy prices for U.S. consumers and businesses.

The bill's key provision would close the so-called "Enron loophole," a measure that was inserted at the behest of Enron and other large energy traders into the Commodity Futures Modernization Act of 2000 and enacted into law. Since 2000, the Enron loophole in Section 2(h)(3) of the Commodity Exchange Act has exempted from government oversight the electronic trading of energy commodities by large traders. Using as an example the Amaranth case history in which a single hedge fund dominated the 2006 U.S. natural gas market and inflated natural gas prices, the Subcommittee investigation demonstrated how the exemption created by the



Enron loophole made it impossible for government regulators to prevent traders from distorting energy prices through large trades on unregulated exchanges. The bill would close the loophole and require any trading facility that functions as an energy exchange to be subject to CFTC oversight to prevent price manipulation and excessive speculation.

The bill would also require the currently unregulated energy exchanges to comply with the same standards as the regulated futures exchanges, like NYMEX; require them to establish trading limits to prevent price manipulation and excessive speculation; provide a comprehensive new definition of energy commodities; and impose large-trader reporting requirements for trades of U.S. energy commodities on foreign exchanges so that U.S. regulators could monitor those trades for price manipulation and excessive speculation.

In May 2008, provisions based upon the Levin bill and the Subcommittee's investigative work were included in the 2008 farm bill, H.R. 6124, and enacted into law. These provisions, in Sections 13201–04 of the farm bill, effectively closed the Enron loophole, by making commodity trades that affect prices subject to CFTC regulation and oversight when made on an exempt electronic exchange, and by requiring the electronic exchanges that handle such trades to comply with the same key operating standards as regulated future exchanges.

*H. Strategic Petroleum Reserve Fill Suspension and Consumer Protection Act (S. 2598/H.R. 6022, Public Law 110–232)*

On February 6, 2008, Senators Dorgan, Bingaman, Levin, Collins, and others introduced S. 2598, the Strategic Petroleum Reserve Fill Suspension and Consumer Protection Act. In 2003, at Senator Levin's request, the Subcommittee issued a Minority staff report showing that an Administration policy of buying oil for the Strategic Petroleum Reserve (SPR) regardless of price was taking millions of barrels of oil off the market for the SPR, reducing private sector supplies, and pushing oil prices higher.

On December 11, 2007, the Subcommittee held a joint hearing with the Subcommittee on Energy of the Committee on Energy and Natural Resources on rising crude oil prices and, again, raised questions about the Administration's SPR fill policy.

In 2007 and 2008, crude oil prices had become very volatile and reached a record high of \$126 per barrel, which led, in turn, to record high prices for fuels produced from crude oil, including gasoline, heating oil, diesel fuel, and jet fuel. These rising prices created new concerns about buying higher-priced oil for the SPR and placing additional pressure on private sector supplies and U.S. oil prices. To relieve this pressure, the bill proposed a moratorium on filling the SPR until U.S. oil prices dropped below a specified level.

On May 19, 2008, a similar companion House bill, H.R. 6022, was approved by Congress and became Public Law 110–232. The moratorium placed on SPR oil purchases remained in place for the rest of the year.

*I. Oil Trading Transparency Act (S. 2995), and Close the London Loophole Act (S. 3129)*

In mid-2008, Senator Levin introduced two additional bills with Senator Feinstein to address energy price manipulation and excessive speculation problems that were not resolved by the energy commodity provisions in the 2008 farm bill. Both of these bills focused on the issue of U.S. energy commodities, such as futures to buy or sell U.S.-produced crude oil and gasoline, that were traded on foreign exchanges outside the regulatory reach of the CFTC.

The Subcommittee's investigative work had found that U.S. crude oil and gasoline futures were traded primarily on two exchanges, one in New York and the other in London. While the CFTC had clear authority to stop trading abuses on the New York exchange, its authority was less clear regarding U.S. energy futures traded on the London exchange. In addition, the Subcommittee's work showed that, under existing law, the CFTC obtained the information it needed to detect price manipulation and excessive speculation involving U.S. futures on foreign exchanges only through voluntary data-sharing agreements arranged with the relevant foreign regulators. In many instances, the CFTC could take an enforcement action against a U.S. trader on a foreign exchange to prevent manipulation or excessive speculation only with the cooperation and consent of the foreign regulator. The Levin-Feinstein bills were designed to close this "London loophole" by ensuring the CFTC had the same authority to detect, prevent, and punish price manipulation and excessive speculation for traders in the United States who traded energy commodities on foreign exchanges as the CFTC had for traders who traded on U.S. exchanges.

On May 8, 2008, the first Levin-Feinstein bill, S. 2995, the Oil Trading Transparency Act, was introduced. This bill sought to require the CFTC to ensure that any foreign exchange operating a trading terminal in the United States for the trading of a U.S. energy commodity met two regulatory requirements that already applied to U.S. exchanges: (1) imposition of speculative trading limits to prevent price manipulation and excessive speculation; and (2) daily publication of trading information from the exchange to ensure market transparency. The bill would also require the CFTC to obtain information from the foreign exchange to enable it to determine how much trading in U.S. energy commodities was due to speculation.

A month later, on June 12, 2008, the second Levin-Feinstein bill, S. 3129, the Close the London Loophole Act, was introduced. This legislation was more extensive than the first bill. In addition to requiring the CFTC to obtain agreements with foreign exchanges to impose position limits on U.S. energy commodities trades and provide daily trading information, the bill sought to strengthen the CFTC's oversight and enforcement capabilities by providing the CFTC with clear legal authority over U.S. traders directing trades through foreign exchanges. For example, the bill would make it clear that the CFTC had the authority to impose its own record-keeping requirements on U.S. traders conducting trades on foreign exchanges, to direct those U.S. traders to reduce their holdings on a foreign exchange when those holdings exceeded applicable position limits, and to prosecute U.S. persons who manipulate or at-

tempt to manipulate the price of a commodity in interstate commerce through trading on a foreign exchange.

The two Levin-Feinstein bills sought to ensure that the U.S. Government had the information, authority, and enforcement tools needed to protect American markets from price manipulation and excessive speculation carried out through foreign exchanges. They also sought to ensure that U.S. energy traders would no longer be able to avoid CFTC oversight and enforcement authority by routing their trades through a foreign exchange. Both bills were referred to the Committee on Agriculture, Nutrition, and Forestry for further consideration.

*J. Over-The-Counter Speculation Act (S. 3255)*

On July 10, 2008, Senators Levin and Feinstein introduced S. 3255, the Over-The-Counter Speculation Act, to give the CFTC oversight authority to stop price manipulation and excessive speculation in the currently unregulated over-the-counter (OTC) markets for commodity trades.

The 2008 farm bill later enacted into law included provisions to impose CFTC regulation and oversight for the first time on electronic exchanges used by large commodity traders. Those provisions did not, however, apply to the rest of the OTC market, which involves commodity trades conducted through voice brokers, swap dealers, direct party-to-party negotiations, or other non-electronic means. Many of these OTC trades involve swap contracts that reference specified commodity prices and, due to the swaps close resemblance to futures contracts, have raised concerns that they might affect commodity prices on regulated futures markets.

The bill would authorize the CFTC for the first time to gather and analyze OTC trading information, conduct inquiries into particular OTC trades, and, if appropriate, require traders to reduce their holdings to prevent price manipulation or excessive speculation. The bill would, in effect, enable the CFTC to police all types of OTC trades in a manner similar to futures trades, and ensure that traders could not avoid CFTC reporting requirements or trading limits by using swaps in the unregulated OTC market instead of futures on a regulated exchange.

The bill was referred to the Committee on Agriculture, Nutrition, and Forestry for further consideration.

*K. Prevent Excessive Speculation Act (S. 3577)*

On September 25, 2008, Senator Levin introduced S. 3577, the Prevent Excessive Speculation Act, together with Senator Harkin, Chairman of the Agriculture Committee, and Senator Bingaman, Chairman of the Energy Committee. This legislation represented their collective efforts to present the strongest and most workable measures to prevent excessive speculation and price manipulation in U.S. energy markets. The bill incorporated a number of measures from prior Levin-Feinstein bills and other legislation, while also adding new provisions. The bill's objectives were to close loopholes in the U.S. commodities laws that impeded U.S. oversight of U.S. energy trades on foreign exchanges and in the OTC markets; ensure that large commodity traders could not use those markets to avoid CFTC oversight or trading limits; and strengthen disclo-

sure, oversight, and enforcement in all aspects of U.S. commodity markets to restore the financial regulation crucial to protecting American consumers, businesses, and economy from further energy and other pricing shocks.

The bill proposed four sets of provisions. First, it would require the CFTC, rather than individual exchanges, to set position limits on the amount of futures contracts any trader can hold on regulated exchanges to prevent excessive speculation and price manipulation. Second, it would close the “London loophole” by giving the CFTC the same authority to police traders in the United States who trade U.S. futures contracts on a foreign exchange as it has to police trades on U.S. exchanges, and by requiring foreign exchanges that want to install trading terminals in the United States to impose comparable position limits as the CFTC imposes on domestic exchanges to prevent excessive speculation and price manipulation. Third, the bill would close the “swaps loophole” by requiring traders in the over-the-counter energy markets to report large trades to the CFTC, and it would authorize the CFTC to set trading limits in the OTC markets to prevent excessive speculation and price manipulation. Finally, it would require the CFTC to revise the standards that allow certain traders who use futures markets to hedge their holdings so that those traders are bound by the same speculation limits that apply to everyone else.

The Levin-Harken-Bingaman bill was referred to the Committee on Agriculture, Nutrition, and Forestry for further consideration.

*L. Incorporation Transparency and Law Enforcement Assistance Act (S. 2956)*

On May 1, 2008, Senators Levin, Coleman, and Obama introduced S. 2956, the Incorporation Transparency and Law Enforcement Assistance Act, to address inadequate State incorporation practices that allow criminals to form new U.S. corporations without disclosing their identities and use those corporations to commit crimes, including terrorism, drug trafficking, money laundering, tax evasion, financial fraud, and corruption.

The legislation was based upon a 2006 Subcommittee investigation as well as two GAO reports requested by the Subcommittee examining the problem of U.S. corporations with hidden owners. The Subcommittee investigation found that the 50 States establish nearly two million U.S. companies each year without knowing who is behind them, inviting money laundering, tax evasion and other misuse of U.S. companies. During the Subcommittee’s 2006 hearing, the Department of Justice, IRS, and Department of Treasury’s Financial Crimes Enforcement Network each testified that the failure of States to collect beneficial ownership information for the legal entities they form has impeded Federal efforts to investigate and prosecute terrorism and other crimes.

In response to the concerns expressed at the hearing, the National Association of Secretaries of State developed a proposal to strengthen State incorporation practices, but it fell far short of the needed reforms. Because the States appeared unable to resolve the problem on their own, S. 2956 was introduced to set minimum standards for the States to acquire beneficial ownership information for the corporations or limited liability companies they form,

and to provide that information to law enforcement in response to a subpoena or summons. The bill was referred to the Committee on Homeland Security and Governmental Affairs for further consideration.

#### IV. REPORTS, PRINTS, AND STUDIES

A. *Excessive Speculation in the Natural Gas Markets, June 25, 2007*  
(Report Prepared by the Majority and Minority Staffs and released in conjunction with the Subcommittee Hearing on June 25, 2007) (Printed in June 25th and July 9th hearing record.)

Since 2001, the Subcommittee has been examining the structure, operation, and pricing mechanisms of U.S. energy markets. In June 2006, the Subcommittee issued a report, *The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat* analyzing the extent to which the increasing amount of financial speculation in energy markets had contributed to the steep rise in energy prices over the past few years. The report concluded, "Speculation has contributed to rising U.S. energy prices," but also that "gaps in available market data" made quantification of the speculative component problematic.

Shortly after the Subcommittee issued its report in 2006, the natural gas market entered a period of extreme price volatility punctuated by the collapse in September 2006 of Amaranth LLC ("Amaranth"), one of the largest hedge funds in the natural gas market. From the last week in August to the middle of September 2006, Amaranth's natural gas positions lost over \$2 billion in value, precipitating the liquidation of the entire portfolio of the \$8 billion fund.

The collapse followed a period in late summer when natural gas prices began falling. For example, the price of the NYMEX futures contract to deliver natural gas in October 2006 fell from a high of \$8.45 per MMBtu in late July to just under \$4.80 per MMBtu in September, the lowest level for that contract in over 2 years. Throughout this period, despite the price change, the market fundamentals of supply and demand were largely unchanged. Natural gas supplies were plentiful, and the amount of natural gas in storage remained higher than average throughout the summer and into the early fall.

In October 2006, the Subcommittee began its investigation into the falling prices for natural gas and Amaranth's collapse. The Subcommittee analyzed millions of natural gas transactions from trading records obtained from NYMEX and ICE, the two principal exchanges for energy commodities, and from Amaranth and other traders. In addition, the Subcommittee conducted numerous interviews of natural gas market participants, including natural gas traders, producers, suppliers, and hedge fund managers, as well as exchange officials, regulators, and energy market experts. NYMEX, ICE, Amaranth and many traders cooperated with detailed inquiries. The Subcommittee also reviewed commodity market statutes and regulations, and researched a variety of legal issues.

This investigation culminated in a hearing and the release of a 400-page bipartisan staff report on June 25, 2007. The trading records examined by the Subcommittee disclosed that, from early



2006 until its September collapse, Amaranth had dominated trading in the U.S. natural gas financial markets. Amaranth had held as many as 100,000 natural gas contracts in a single month, representing 1 trillion cubic feet of natural gas, or 5 percent of the natural gas used in the entire United States in a year. At times Amaranth controlled 40 percent of all of the outstanding contracts in the NYMEX exchange for natural gas in the winter season (October 2006 through March 2007), including as much as 75 percent of the outstanding contracts to deliver natural gas in November 2006.

The report found that Amaranth's large positions and trades caused significant price movements in key natural gas futures prices and price relationships. For example, Amaranth's purchases of contracts to deliver natural gas in the winter months, in conjunction with Amaranth's sales of natural gas contracts for delivery in the summer months, drove winter prices far above summer prices. These differences between winter and summer prices, called "price spreads," were far higher in 2006 than in previous years—until the collapse of Amaranth, when the price spreads returned to more normal levels. On several specific dates, Amaranth's massive trades were responsible for large jumps in the price differences between the futures contracts for March and April 2007. Traders interviewed by the Subcommittee said that during the spring and summer of 2006 the differences between winter and summer prices were "clearly out-of-whack," at "ridiculous" levels, and unjustified by supply or demand.

The report found that many market participants were harmed by Amaranth's massive speculative trading. For example, utilities that provide gas-powered electricity or heating to homes, schools, and hospitals, and some industries that use natural gas in manufacturing paid inflated prices. Many of their costs were passed onto consumers.

The report also found that the current regulatory system was unable to prevent Amaranth's excessive speculation in the 2006 natural gas market. Under current law, NYMEX is required to monitor the positions of its traders to determine whether a trader's positions are too large. If a trader's position exceeds pre-set "accountability levels," the exchange may require a trader to reduce its positions. The Amaranth case history demonstrated two critical flaws. First, NYMEX had no routine access to information about a trader's positions on ICE, the other principal commodity exchange, in determining whether a trader's positions were too large. It was therefore impossible under the current system for NYMEX to have a complete and accurate view of a trader's position in determining whether it was too large.

Second, the case history showed that, even if NYMEX ordered a trader to reduce its positions on NYMEX, that trader could simply shift its positions to ICE where no limits applied. The case history showed that is precisely what Amaranth did after NYMEX finally told Amaranth, in August 2006, to reduce its positions in two contracts nearing expiration. NYMEX's instructions to Amaranth did nothing to reduce Amaranth's size, but simply caused Amaranth's trading to move from a regulated market to an unregulated one.

The evidence provided in the report showed that NYMEX and ICE were functionally equivalent markets. Natural gas traders used both markets, employing coordinated trading strategies. In many instances the trading volumes on ICE were comparable to or greater than the volumes on NYMEX. Traders used the natural gas contract on NYMEX, called a futures contract, in the same way they used the natural gas contract on ICE, called a swap, for risk management and economic purposes. The data also showed that prices on one exchange affected the prices on the other. Given their equivalence, the report concluded there was no sound basis for one exchange to be regulated and the other not.

The report also explained that the disparity in regulation between NYMEX and ICE was a result of the so-called “Enron Loophole” in the Commodity Exchange Act. The Enron Loophole, which was inserted into the law in 2000 at the request of Enron and others, exempts electronic energy exchanges such as ICE from CFTC oversight and regulation. Unlike NYMEX, there are no limits on the trading on ICE, and no routine government oversight. The Amaranth case history demonstrated that the disparity in regulation of the two markets prevented the CFTC and the exchanges from fully analyzing market transactions, understanding trading patterns, and compiling accurate pictures of trader positions and market concentration; it required them to make regulatory judgments on the basis of incomplete and inaccurate information; and it impeded their authority to detect, prevent, and punish market manipulation and excessive speculation.

The report’s landmark analysis of NYMEX and ICE trades demonstrated the interconnectedness of the two markets, and the inherent problems with regulating one of them but not the other. To repair the broken regulatory system, the report offered a number of recommendations. First, the report recommended that Congress close the Enron Loophole to require unregulated exchanges, such as ICE, to comply with the same statutory obligations as regulated markets, such as NYMEX. The report also recommended that the CFTC, if given additional legal authority, monitor both ICE and NYMEX and conduct oversight of aggregate trading positions in both markets. Third, the report recommended that Congress increase the CFTC budget and authorize user fees on the commodity traders to provide the additional staff and technology needed to conduct stronger oversight and put a stop to price manipulation and excessive speculation in the commodity markets.

*B. Dirty Bomb Vulnerabilities, July 12, 2007 (Report Prepared by the Majority and Minority Staffs and released in conjunction with the Subcommittee’s Hearing on July 12, 2007) (Printed in July 12th hearing record.)*

On July 12, 2007, as part of its ongoing examination of nuclear and radiological threats to the United States, the Subcommittee released a bipartisan report prepared by the Majority and Minority staffs summarizing the Subcommittee’s investigation into certain vulnerabilities related to the materials licensing policies and procedures of the Nuclear Regulatory Commission (NRC) and offering several recommendations to strengthen NRC safeguards. This re-

port was released in conjunction with a Subcommittee hearing on the same date.

The report focused on the process by which parties obtain NRC materials licenses, the vulnerability of NRC materials licenses to counterfeiting and fraud, and several long-standing weaknesses in the NRC licensing procedures. The report also described a GAO effort, undertaken at the request of the Subcommittee, to test whether the NRC's licensing procedures were sufficient to guard against the aggregation and misuse of relatively low-grade radioactive materials, including efforts to include these materials in a so-called "dirty bomb"—a conventional bomb used to disburse radioactive materials.

The report explained that the NRC and certain "Agreement States" to which the NRC has delegated authority are responsible for regulating the possession and use of low-grade radiological materials within U.S. borders. The report detailed the procedures used by the NRC and Agreement States to issue licenses allowing applicants to possess and use certain radiological materials available in a variety of medical and industrial fields. The report also described how GAO used aliases and a sham corporation to test the effectiveness of those procedures. The sham corporation applied simultaneously for two materials licenses—one through an Agreement State and one from the NRC. Because the Agreement State, as part of its licensing process, insisted on interviews with company officials and a physical tour of the company's facilities, GAO withdrew its application. In contrast, because the NRC opted not to conduct a site visit or in-person interviews with the sham company's officials, GAO's sham corporation was able in less than 30 days to obtain an official NRC license to take possession of radiological materials. The report described how GAO then used off-the-shelf computer software to electronically scan the NRC license, create a near-identical facsimile, and use that counterfeit license to contract with two different companies to purchase radiological devices. The report showed how GAO used the counterfeit license to circumvent restrictions on the quantity of radioactive materials it was permitted to purchase, and concluded that GAO could have purchased enough radioactive materials to meet the NRC's definition of a "dangerous" quantity—enough to build a dirty bomb.

The report also detailed past reports from GAO, the NRC Inspector General, and this Subcommittee which identified problems and made recommendations to strengthen the NRC licensing procedures to prevent abuses. The report analyzed the NRC's response to those recommendations as well as ongoing licensing vulnerabilities. The report offered several recommendations to further strengthen NRC licensing procedures, including urging the NRC to: (1) reevaluate the apparent good-faith presumption that pervades its licensing process; (2) regulate Category 3 sources more stringently by physically inspecting applicants' facilities before the issuance of a Category 3 materials license, and considering including Category 3 sources in the proposed National Source Tracking System; and (3) acting quickly to establish a Web-Based Licensing System to ensure that source materials can be obtained only in authorized amounts by legitimate users.

In response to the Subcommittee's hearing and report, the NRC proposed performing a retrospective examination of certain licenses issued by the NRC to verify that the licensees were legitimate; reevaluating NRC licensing procedures and guidance; and examining options to combat counterfeit licenses; and reevaluating security measures. The NRC also established an "Independent External Review Panel to Identify Vulnerabilities in the NRC's Materials Licensing Program," a "Materials Program Working Group," and a "Pre-Licensing Guidance Working Group." The Independent Review Panel and NRC staff embraced virtually all of the report's recommendations. Most notably, the NRC recognized the need to suspend its "good faith presumption" that new applicants seeking radioactive materials were honest and hasten the implementation of a National Source Tracking System and a Web-Based Licensing System.

*C. United Nations Development Program: A Case Study of North Korea, January 24, 2008 (Report Prepared by the Majority and Minority Staffs and released in conjunction with the Subcommittee's Hearing on January 24, 2008) (Printed in January 24th hearing record.)*

Since 2004, the Subcommittee has conducted a bipartisan investigation into evidence of waste, fraud, and mismanagement in United Nations programs and operations. The first phase of that investigation examined the United Nations Oil-for-Food Program and resulted in four Subcommittee hearings and five staff reports disclosing widespread problems with that program. In 2007, the Subcommittee commenced an examination into allegations of mismanagement and misconduct in the operations of the United Nations Development Program (UNDP) in the Democratic People's Republic of Korea (DPRK). On January 24, 2008, the Subcommittee released a bipartisan staff report summarizing its investigation. That report was released in conjunction with a Subcommittee hearing on the same day.

The report contained a number of findings of fact and recommendations. It found, for example, that the UNDP had operated in North Korea with inappropriate staffing, questionable use of foreign currency instead of local currency, and insufficient administrative and fiscal controls. The report found that the UNDP's DPRK office was staffed in large part with North Korean nationals who were selected by the DPRK, contrary to UNDP policy; and that the UNDP had paid the salaries of local staff directly to the North Korean government without ensuring that the monies were disbursed to the workers and despite suspicions that the DPRK was, in the words of one UNDP official, "skimming" money from the payments. The report also found that the UNDP paid salaries and other expenses in convertible currencies, such as U.S. Dollars or Euros, rather than in the local currency, contrary to UNDP's best practices; and UNDP was allowed to conduct on-site project visits only with prior notice and in the company of North Korean officials, again contrary to UNDP's best practices.

In addition, a Subcommittee review of a UNDP internal audit revealed that nearly half of the UNDP projects in North Korea were conducted under a National Execution Strategy that ostensibly re-

quired direct payments to the host government for the implementation of UNDP projects. The Subcommittee learned, however, that by agreement with North Korea, UNDP maintained control of most of the projects' financing and management. UNDP officials explained to the Subcommittee that, by directly controlling funds that were ostensibly slated to be managed nationally, UNDP accomplished two objectives: it respected sensitivities about national sovereignty and formal control over projects within a country's borders, and it executed the projects using UNDP management and controls. In the case of the UNDP program in North Korea, however, this strategy also led to confusion over the amount of direct payments actually made to North Korea. In sum, UNDP operations in North Korea were carried out under significant constraints that undermined its standard administrative, fiscal, and program controls.

The report also showed how, in 2002, the DPRK government had used its relationship with the United Nations to execute deceptive financial transactions, by moving over \$2.7 million of its own funds from Pyongyang to DPRK diplomatic missions abroad through a bank account intended to be used solely for UNDP activities and by referencing UNDP in the wire transfer documentation. UNDP has stated that the wire transfers were wholly unrelated to its development projects, and North Korean officials have confirmed that the funds originated with the DPRK Ministry of Foreign Affairs and were not related to the UNDP. North Korean officials explained to the Subcommittee that these transfers occurred soon after President George Bush's 2002 State of the Union address in which he described North Korea as part of an "axis of evil," that they expected sanctions against their country; and used the UNDP-related account as a more secure channel to fund their embassies abroad. The report also found that the UNDP had transferred U.N. funds to a company that, according to a letter from the U.S. State Department to UNDP, had ties to an entity involved in DPRK weapons activity.

Finally, the report found that, by preventing access to its audits and not submitting to the jurisdiction of the U.N. Ethics Office, the UNDP had impeded reasonable oversight and undermined its whistleblower protections. The UNDP had commissioned four audits of its North Korean operations in 1999, 2001, 2004, and 2007. Problems were identified in all four. The first three audits were non-public and, in accordance with UNDP policy, unavailable for review even by nations serving on the UNDP Executive Board. After repeated requests, UNDP made an exception to this policy and, in 2007, showed the audit reports to the U.S. Mission to the United Nations, whose personnel were allowed to read but not copy them. The Subcommittee obtained copies from other sources and found the audits to be of great assistance in examining UNDP operations in North Korea. In addition, the Subcommittee spoke with Artjon Shkurtaj, former Operations Manager of the UNDP office in Pyongyang, who had raised concerns about management and operational deficiencies. After raising these concerns, Mr. Shkurtaj's UNDP employment contract was not renewed. He filed a complaint with the U.N. Ethics Office claiming retaliation. The U.N. Ethics Office determined that, although Mr. Shkurtaj had established "a



prima facie case of retaliation,” it lacked jurisdiction to decide his claim and the UNDP declined a request to voluntarily submit the Shkurtaj matter for a U.N. Ethics Office review. The report found that these actions had undermined confidence among U.N. employees that U.N. whistleblowers who speak out about U.N. mismanagement would be protected from retribution. In November 2007, the U.N. Secretary General issued a bulletin requiring each U.N. agency to establish its own ethics office or submit to the jurisdiction of the U.N. Ethics Office within the Secretariat.

The report offered several recommendations to strengthen UNDP management. First, the report recommended that the UNDP provide U.N. member states with unfettered access to UNDP audit reports. The report recommended that UNDP approve a pending proposal to grant routine access to UNDP Executive Board members to UNDP audit reports, and broaden the proposal to allow access to past audit reports, photocopying of the reports, and release of audit information to the public, absent exceptional circumstances. Second, the report recommended that the UNDP ensure that whistleblowers do not face retaliation for disclosing improper conduct. Third, the report recommended that the UNDP take steps to ensure that its name and resources are not used as cover for non-U.N. activities. In particular, UNDP should require host countries to establish a bank account designated for exclusive use on UNDP development projects, prohibit the deposit of any other funds in the account, and mandate, as a condition precedent for the receipt of development aid, that the host country designate UNDP as a secondary account signatory and authorize the financial institution to grant UNDP access to all account documentation so that UNDP can monitor the account activity. Finally, the report recommended that, prior to making payments to a vendor, UNDP take steps to ensure the vendor is not associated with illicit activity, including by checking U.N. lists of suspect entities. The report also recommended that Congress and the U.S. State Department press for each of the suggested reforms.

*D. Medicare Vulnerabilities: Payments for Claims Tied to Deceased Doctors, July 9, 2008 (Report Prepared by the Majority and Minority Staffs and released in conjunction with the Subcommittee’s Hearing on July 9, 2008) (Printed in July 9th hearing record.)*

As part of its continuing efforts to uncover waste, fraud, and abuse in the Medicare and Medicaid programs, on July 9, 2008, the Subcommittee released a bipartisan staff report on the payment by Medicare of durable medical equipment (DME) claims using identification numbers belonging to deceased physicians. Using Medicare data from 2000 to 2007, the report estimated that nearly half a million Medicare payments, totaling at least \$76 million, had been provided to medical equipment suppliers submitting DME claims that used identifiers for at least 17,000 deceased doctors, which is about half of the deceased doctor population. The Subcommittee held a hearing on the same day.

The report explained that Medicare regulations require DME claims to contain certain information in order to qualify for payment, including the identification number of the prescribing med-

ical provider. That identifier, until recently, was called the Unique Physician Identification Number (UPIN). In 2001, the Inspector General (IG) of the U.S. Department of Health and Human Services (HHS) issued a report alerting the Centers for Medicare and Medicaid Services (CMS) to failures in the UPIN system after finding that, in 1999 alone, over \$90 million had been paid for medical equipment claims with invalid UPINs. In response, in 2002, CMS instructed the contractors that maintained the UPIN registry to review the UPIN database, eliminate UPINs for deceased physicians, and keep the registry updated going forward. The contractors were also told to modify the claims process to bar payment of claims with invalid UPINs. CMS reported to the HHS IG that the needed UPIN reforms had been completed, but neither CMS nor its contractors ever tested them to ensure they worked. The Subcommittee's investigation showed that, despite the 2002 reforms, CMS continued to pay millions of dollars of Medicare claims referencing UPINs for deceased physicians.

The report summarized the Subcommittee's investigation, and offered a number of findings and recommendations. The report estimated that, from 2000 to 2007, Medicare paid between \$76 million and \$92 million for hundreds of thousands of DME claims that contained identification numbers assigned to an estimated 16,500 to 18,200 deceased physicians. About 51,000 of those claims, or 16 percent of the total, valued at roughly \$4 million, contained UPINs for doctors who had died ten or more years before the service date on the claims. The report cited one instance in which a UPIN belonging to a deceased physician in Florida was used for 484 claims between November 2005 and November 2006, totaling more than \$544,000, even though the corresponding physician had died in 1999. In another instance, the UPIN assigned to a doctor who died in 2001, was used on more than 3,800 claims submitted between 2002 and 2007, resulting in Medicare payments of more than \$354,000.

The report noted that these problems were not new to CMS, which had been alerted to them in the HHS IG's 2001 report. The report found, however, that the 2002 procedures put into place by CMS to ensure that DME claims with UPINs of deceased physicians would be rejected, were ineffective in resolving the problem, and HHS and CMS personnel failed to perform the reviews or audits needed to ensure the procedures were working. In fact, 63 percent of the claims identified by the Subcommittee as using deceased physician UPINs were paid with dates of service after April 1, 2002, the date after which Medicare was supposed to reject such claims. The report also found that, as of May 2008, the UPINs of an estimated 2,000 to 2,900 deceased physicians remained active, and the continuing inability of CMS payment systems to reject claims containing deceased physician identifiers rendered Medicare vulnerable on a continuing basis to millions of dollars in improper claims each year.

The report offered several recommendations to stop the abuses. First, it recommended that CMS strengthen its procedures to deactivate physician identifier numbers after a physician died, and develop a quality control program to ensure those deactivations are taking place within a specified period of time after CMS receives

notice of a physician's death, such as 90 days. Second, the report recommended initiating periodic audits of the Medicare physician registry to test whether identifiers assigned to deceased physicians have been deactivated and of Medicare payment records to test whether claims containing deceased physician identifiers were rejected. Third, the report recommended that CMS consider instituting additional procedures and audits to ensure the prompt deactivation of identifiers assigned to Medicare service providers who have stopped providing services for other reasons than death, such as licensure revocation or retirement, including automatic deactivation of any identifier that has not been used in a Medicare claim within a specified time period, such as 12 months.

*E. Tax Haven Banks and U.S. Tax Compliance, July 17, 2008 (Report Prepared by the Majority and Minority Staffs and released in conjunction with the Subcommittee's Hearing on July 17, 2008) (Printed in the July 17th and 25th hearing records.)*

As part of its ongoing efforts to combat offshore tax abuse, on July 17, 2008, the Subcommittee released a staff report showing how two tax haven banks, LGT Bank in Liechtenstein and UBS in Switzerland, helped U.S. clients evade U.S. taxes by opening offshore accounts, concealing their assets, and using financial services in ways that did not alert U.S. authorities to the existence of their foreign accounts. The Subcommittee released the report in conjunction with two days of hearings.

The report summarized the Subcommittee's investigation and offered a number of findings and recommendations. First, it highlighted eight case histories of U.S. clients with offshore accounts at LGT or UBS. It described, for example, the Marshes of Florida who hid \$49 million in four Liechtenstein foundations over 20 years; William Wu who concealed ownership of his assets, including his New York residence, using an elaborate offshore structure; the Lowys of California who used shell companies and a Delaware corporation to hide their beneficial interest in a Liechtenstein foundation with \$68 million in assets; a father and son who met LGT private bankers, including a Liechtenstein Prince, to discuss transferring \$30 million in offshore funds from the Bank of Bermuda to LGT; and Igor Olenifcoff, a California real estate magnate who worked with a UBS private banker to hide \$200 million in assets in Switzerland and Liechtenstein.

The report found that offshore bank secrecy laws and practices were serving as a cloak, not only for client misconduct, but also for misconduct by banks colluding with clients to evade taxes, dodge creditors, and defy court orders. The report found that, from at least 2000 to 2007, LGT and UBS employed banking practices that could facilitate, and did result in, tax evasion by their U.S. clients, including assisting those clients to open accounts in the names of offshore entities; advising clients on complex offshore structures to hide ownership of assets; using client code names; and disguising asset transfers into and from accounts. In addition, the report found that, since 2001, LGT and UBS had collectively maintained thousands of U.S. client accounts with billions of dollars in assets that had not been disclosed to the IRS. UBS alone had admitted maintaining accounts in Switzerland for an estimated 19,000 U.S.

clients with assets valued at \$18 billion, while the IRS has identified at least 100 accounts with U.S. clients at LGT.

Finally, the report found that LGT and UBS had assisted their U.S. clients in structuring their foreign accounts to avoid required reporting to the IRS under the so-called Qualified Intermediary (QI) Program, which requires participating foreign financial institutions to report and withhold tax on U.S. source income paid to foreign bank accounts. The report described how the banks had allowed U.S. clients who sold their U.S. securities to continue to hold undisclosed accounts or to open new accounts in the name of offshore shell corporations which they secretly owned. The report found that the banks used these banking practices to keep accounts secret from the IRS and thereby facilitated tax evasion by their U.S. clients.

The report contained numerous recommendations to stop tax haven banks from facilitating U.S. tax evasion. Those recommendations included penalizing tax haven banks that impeded U.S. tax enforcement by terminating their QI status; enacting legislation allowing the Treasury to bar such banks from doing business with U.S. financial institutions; and enacting legislation extending from 3 years to 6 years the amount of time the IRS has after a tax return is filed to assess additional tax if the case involves an offshore tax haven with secrecy laws. The report also recommended strengthening the QI reporting program by requiring QI participants to file 1099 Forms with the IRS for: (1) all U.S. persons who are clients (whether or not the client has U.S. securities or receives U.S. source income); and (2) accounts beneficially owned by U.S. persons, even if the accounts are held in the name of a foreign corporation, trust, foundation, or other entity. In addition, the report recommended closing the “QI-KYC Gap” by expressly requiring QI participants to apply to their QI reporting obligations all information obtained through their Know-Your-Customer procedures, including the identification of all beneficial owners of an account.

*F. Dividend Tax Abuse: How Offshore Entities Dodge Taxes on U.S. Stock Dividends, September 11, 2008 (Report Prepared by the Majority and Minority Staffs and released in conjunction with the Subcommittee’s Hearing on September 11, 2008) (Printed in Sept. 11th hearing record.)*

As part of its ongoing efforts to combat offshore tax abuse, on September 11, 2008, the Subcommittee released a staff report exposing practices at nearly a dozen financial institutions showing how U.S. financial institutions knowingly developed, marketed, and implemented a wide range of transactions aimed at enabling their non-U.S. clients to dodge payment of U.S. dividend taxes. The Subcommittee released the report in conjunction with a hearing held the same day.

Foreigners who invest in the United States are exempt from many U.S. taxes—they do not pay taxes on interest earned on money deposited in a U.S. bank, nor do they pay taxes on capital gains. However, if they invest in a U.S. company and the stock pays a dividend, U.S. law requires the foreign investor to pay a tax on the dividend. Dividends sent abroad are subject to tax at a rate of 30 percent in most countries, and 15 percent in countries having

a tax treaty with the United States. The report found that many non-U.S. clients escape paying the required tax through the assistance of U.S. financial institutions.

The report summarized the Subcommittee's investigation and offered a number of findings and recommendations. It first described six case histories of dividend tax abuse, involving Lehman Brothers, Morgan Stanley, Deutsche Bank, UBS, Merrill Lynch, and Citigroup. Using a variety of complex financial instruments, primarily involving equity swaps and stock loans, these U.S. financial institutions structured transactions to enable their non-U.S. clients to enjoy all of the economic benefits of owning shares of U.S. stock, including receiving dividends, without paying the tax applicable to those dividends. These structured transactions increased the amount of dividend returns obtained by some of their non-U.S. clients by 30 percent or more.

Additionally, the report found that U.S. financial institutions frequently cooperated with offshore hedge funds to negotiate and carry out abusive dividend tax transactions. Offshore hedge funds actively sought these abusive transactions, negotiated the terms of the arrangements with the financial institutions, and at times played one financial institution against another to elicit the largest possible tax reduction. The report also found that many of the offshore hedge funds benefiting from these tax dodges did not maintain physical offices or investment professionals in their offshore locations, and instead operated primarily under the control of U.S. persons serving as the fund's general partner or investment manager. In these cases, U.S. hedge fund managers and their employees often played key roles in facilitating the offshore dividend tax abuse.

The report found that, as a result of the offshore dividend tax abuses, billions of dollars in U.S. taxes that should have been paid into the Treasury were lost. For example, the report cited Morgan Stanley data indicating that, over a 7-year period from 2000–2007, its dividend tax transactions enabled clients to escape payment of U.S. dividend taxes totaling more than \$300 million. In another example, the investment manager of a group of related offshore hedge funds, Maverick Capital Management, calculated that over an 8-year period, from 2000 to 2007, it had entered into "U.S. Dividend Enhancements" with a variety of firms that enabled it to escape paying U.S. dividend taxes totaling nearly \$95 million.

The report also found that the responsible Federal agencies, the Treasury Department and the IRS, had failed to prevent or punish dividend tax abuse. The agencies had failed to publish for 10 years final regulations to address abusive stock loans, failed to clarify existing regulations related to abusive equity swaps, and failed to take enforcement actions against participating financial institutions or their clients. The report found that, while the instances of abuse multiplied, the silence and inaction of the Treasury Department and the IRS encouraged the spread of offshore dividend tax abuse.

The report offered several recommendations to end dividend tax abuses, including by enacting legislation to make it clear that non-U.S. persons cannot avoid U.S. dividend taxes by using a swap or stock loan to disguise dividend payments, and by eliminating the



different tax rules for U.S. stock dividends, dividend equivalent payments, and dividend substitute payments, and making them all equally taxable as dividends. The report also recommended that the IRS complete its ongoing review of dividend-related transactions and take civil enforcement action against taxpayers and U.S. financial institutions that knowingly participated in abusive transactions aimed at dodging U.S. taxes on stock dividends. In addition, to stop misuse of equity swap transactions to dodge U.S. dividend taxes, the report recommended that the IRS issue a new regulation to make dividend equivalent payments under equity swap transactions taxable to the same extent as U.S. stock dividends. To stop misuse of stock loan transactions to dodge U.S. dividend taxes, the report recommended that the IRS issue a new regulation to make clear that inserting an offshore entity into a stock loan transaction does not eliminate U.S. tax withholding obligations for stock dividends.

*G. Medicare Vulnerabilities: The Use of Diagnosis Codes in DME Claims (Report Prepared by the Minority Staff of the Permanent Subcommittee on Investigations on September 24, 2008 and released in conjunction with the Subcommittee's Hearing on July 9, 2008) (Printed in July 9th hearing record.)*

As part of its ongoing efforts to uncover waste, fraud, and abuse in the Medicare and Medicaid programs, on September 24, 2008, the Subcommittee released a Minority staff report on the use of diagnosis codes in claims for durable medical equipment (DME). Medicare DME claims include diagnosis codes identifying the ailment of the Medicare beneficiary purchasing the medical equipment. In order to determine if those diagnoses codes could be used to prevent waste, fraud or abuse, the Subcommittee examined data related to millions of DME claims. This review uncovered numerous claims using invalid diagnosis codes and diagnosis codes that, while valid, appeared unrelated to the claimed medical equipment.

The report summarized the Subcommittee's investigation and offered several findings and recommendations. The report described the Subcommittee's examination of DME claims data from 1995 to 2006. This review found \$4.8 billion in Medicare payments for 60 million DME items in which the claims contained diagnosis codes that were invalid, blank, or impossible to process. To further test these DME claims, the Subcommittee conducted a detailed review of a subset of 2,000 claims, in which the Subcommittee could verify only 30 percent of the claims as legitimate. The report noted that many of the unverified claims contained indicators of fraudulent activity, such as the identification number of a doctor who had died years earlier or of doctors who denied that they had prescribed the indicated items or treated the indicated patients. The review also uncovered DME claims that paid for medical equipment or supplies that appeared wholly unrelated to the listed ailment. For example, the Subcommittee reviewed hundreds of thousands of claims paid by Medicare for blood glucose test strips, which are used by diabetics to test their blood-sugar levels, and found many with diagnosis codes unrelated to diabetes, listing such ailments as chronic airway obstruction, bubonic plague, leprosy, or cholera.

In addition to these findings, the report identified a number of procedural and regulatory issues. It found, for example, that Medicare rules governing the use of diagnostic codes on DME claims had been inconsistent over time, and that some of the Medicare claims data on diagnosis codes was incorrect or outdated. The report also found that Medicare had not used diagnosis codes effectively in the claims review process. The report noted that Medicare limited its analysis to the presence of a valid diagnosis code, and failed to use the diagnosis codes to evaluate the validity or medical necessity of the claim being presented. The report found that diagnosis codes could be used in many instances to detect and prevent fraudulent, wasteful, or abusive claims.

The report provided several recommendations to CMS in light of the Subcommittee's findings. First, the report recommended that CMS strengthen its claims review process to ensure that all diagnosis codes submitted on claims be not only valid, but medically related to the claimed DME supplies, and that claims with invalid or incorrect codes are rejected and returned to the biller for correction. The report also recommended that CMS consider developing procedures to link diagnosis codes with medical procedures to prevent and reject improper payments. The report recommended that CMS also consider developing procedures to link DME claims with corresponding claims for doctor visits and medical treatment. Finally, the report recommended that CMS strengthen its oversight of its payment contractors, including by imposing penalties for making improper payments or failing to maintain reliable data.

#### V. REQUESTED AND SPONSORED REPORTS

In connection with its investigations, the Subcommittee makes extensive use of the resources and expertise of the Government Accountability Office (GAO), the Offices of Inspectors General (OIGs) at various Federal agencies, and other entities. During the 110th Congress, the Subcommittee requested a number of reports and studies on issues of importance to Congress and to U.S. consumers. Most of these reports have already been described in connection with Subcommittee hearings. Several additional reports that were of particular interest, and that were not covered by Subcommittee hearings, are the following.

A. *Highway Bridge Program: Clearer Goals and Performance Measures Needed for a More Focused and Sustainable Program (GAO-08-1043), September 10, 2008*

The August 1, 2007, collapse of a Minnesota bridge raised urgent questions about bridge safety nationwide, as well as efforts by the U.S. Department of Transportation (DOT) to prioritize resources to address varying bridge safety problems. The Subcommittee and the Senate Committee on Environment and Public Works made a joint request to GAO to evaluate how Federal, State, and local transportation officials carry out the Highway Bridge Program (HBP), the primary source of Federal funding for bridges. GAO's report examined: (1) how the HBP addresses bridge conditions, (2) how States use HBP funds and select bridge projects for funding, (3) what data indicate about bridge conditions and the HBP's impact, and (4) the extent to which the HBP aligns with principles GAO developed,

based on prior work and Federal laws and regulations, for re-examining surface transportation programs.

GAO found, based on information gathered during bridge inspections that are generally conducted every 2 years, that the HBP classifies bridge conditions as deficient or not; assigns each bridge a sufficiency rating reflecting its structural adequacy, safety, serviceability, and relative importance; and uses that information to distribute funding to States. While each State's HBP apportionment amount is largely determined by bridge conditions and bridges generally must be below a certain condition threshold to qualify for HBP funding, other bridges are also eligible for HBP funds because States may use the funds for a broad array of other purposes, such as bridge systematic preventive maintenance projects. States have discretion in how they choose to spend HBP funds and select bridge projects in a variety of ways.

GAO found that bridge conditions, as measured by the number of deficient bridges and average sufficiency rating, improved from 1998 through 2007. However, the impact of the HBP on that improvement was difficult to determine, in part, because (1) the program provides only a share of what States spend on bridges and there are no comprehensive data for State and local spending on bridges, and (2) HBP funds can, in some cases, be used for a variety of bridge projects without regard to a bridge's deficiency status or sufficiency rating.

GAO determined that the HBP lacks focus, performance measures, and sustainability. For example, the program's statutory goals are not focused on a clearly identified Federal or national interest, but rather have expanded from improving deficient bridges to supporting seismic retrofitting, preventive maintenance, and many other projects, thus expanding the Federal interest to potentially include almost any bridge in the country. In addition, GAO found that the program lacks measures linking funding to performance and is not financially sustainable, given the anticipated deterioration of the Nation's bridges and the declining purchasing power of funding currently available for bridge maintenance, rehabilitation, and replacement.

*B. Tax Administration: Comparison of the Reported Tax Liabilities of Foreign- and U.S.-Controlled Corporations, 1998–2005 (GAO–08–957), July 24, 2008*

The Subcommittee has a longstanding interest in tax abuse issues involving U.S. corporations, including corporations that use transfer pricing strategies to shift profits offshore to avoid the payment of U.S. taxes. In three prior reports, GAO examined U.S. corporations that reported paying little or no tax, and examined differences in those corporations that were U.S. versus foreign-controlled. Subcommittee Chairman Levin, Senator Dorgan, and the Joint Committee on Taxation asked GAO to update its previous reports by comparing: (1) the tax liabilities of U.S.-controlled corporations (USCC) and foreign-controlled domestic corporations (FCDC)—including those reporting zero tax liabilities for 1998 through 2005 (the latest available data); and (2) the characteristics of those USCCs and FCDCs such as age, size, and industry.

The data collected by GAO indicated that the majority of corporations reviewed had reported no tax liability for the years 1998 to 2005. During this 8-year period, GAO found that over 1.2 million USCCs paid no tax (67 percent of returns), despite total gross receipts of \$2.1 trillion; and that over 38,000 FCDCs that paid no tax (65 percent of returns) despite total gross receipts of \$435 billion. In addition, GAO found that about 72 percent of large FCDCs versus 55 percent of large USCCs had reported no tax liability for at least 1 year over the 8 years studied.

GAO also found that, by most measures in the report, FCDCs reported lower tax liabilities than USCCs. A greater percentage of large FCDCs reported no tax liability in a given year from 1998 through 2005. For all corporations, a higher percentage of FCDCs reported no tax liabilities than USCCs through 2001, but differences after 2001 were not statistically significant. Most large FCDCs and USCCs that reported no tax liability in 2005 also reported that they had no current-year income. A smaller proportion of these corporations had losses from prior years and tax credits that eliminated any tax liability. By another measure, large FCDCs were more likely to report no tax liability over multiple years than large USCCs. In 2005, comparisons of FCDCs and USCCs based on ratios of reported tax liabilities to gross receipts or total assets showed that FCDCs reported less tax than USCCs.

GAO found that FCDCs and USCCs differed in age, size, and industry. FCDCs were younger than USCCs in that a greater percentage had been incorporated for 3 years or less from 1998 through 2005. In 2005, FCDCs were larger on average than USCCs in that they reported higher average gross receipts and assets than USCCs. A comparison by industry in 2005 showed that large FCDCs were relatively more concentrated in manufacturing and wholesale trade, while large USCCs were more evenly distributed across industries. GAO did not attempt to determine the extent to which these factors and others, such as transfer pricing abuses, explained the differences in tax liabilities.

*C. Tax Compliance: Federal Grant and Direct Assistance Recipients Who Abuse the Federal Tax System (GAO-08-31), November 16, 2007*

Since 2004, the Subcommittee has conducted an ongoing investigation into Federal contractors who bid for and receive Federal dollars for their work, while simultaneously owing substantial unpaid taxes. To expand the focus of this investigation, the Subcommittee, as well as the full Committee, asked GAO to examine noncompliant taxpayers who simultaneously did business with or received benefits from the Federal Government through Federal Grant programs. The resulting GAO report was the latest in a series of GAO reports examining weaknesses in the Federal Payment Levy Program and other Federal programs and controls that have allowed tens of thousands of Federal contractors and Medicare providers to receive government money while owing billions of dollars in unpaid taxes. The Subcommittee asked GAO to examine the extent of this problem for entities who receive Federal Grants or direct assistance, including by providing the magnitude of taxes owed, examples of grant recipients involved in abusive or poten-

tially criminal activity, and the efforts being made to prevent delinquent taxpayers from participating in such programs.

GAO determined that while most recipients of Federal Grant and direct assistance payments pay their Federal taxes, as of September 30, 2006, tens of thousands of recipients collectively owed about \$790 million in unpaid Federal taxes. GAO's data included over 2,000 individuals and organizations that received \$124 billion of payments directly from the Federal Government and who owed more than \$270 million of unpaid taxes (almost 6 percent of such recipients) and about 37,000 landlords participating in HUD's Section 8 tenant-based housing program who owed an estimated \$520 million of unpaid taxes (almost 4 percent of such landlords). GAO indicated that the \$790 million estimate is likely substantially understated, because GAO's analysis excluded the 80 percent of Federal Grants that are directly given to State and local governments which, in turn, disburse the grants to the ultimate recipients.

GAO presented 20 cases of grant and direct assistance recipients who had high tax debt and who appeared to be engaged in abusive or potential criminal activity related to the Federal tax system, including failure to remit individual income taxes or payroll taxes to the IRS. Willful failure to remit payroll taxes is a felony under U.S. law, and GAO provided evidence that some of the individuals associated with some of the recipients had diverted payroll tax money to their personal use or to help fund their businesses. GAO referred the 20 cases to the IRS for additional investigation and enforcement action, as appropriate.

GAO also recommended that the Office of Management and Budget consider requiring Federal agencies that issue grants or make direct assistance payments take affirmative steps to determine whether any of their applicants have unpaid tax debt.

*D. Tax Compliance: Some Hurricanes Katrina and Rita Disaster Assistance Recipients Have Unpaid Federal Taxes (GAO-08-101R), November 16, 2007*

In further support of the Subcommittee's ongoing investigation into persons who do business with or receive benefits from the Federal Government while owing Federal taxes, the Subcommittee and full Committee asked GAO to examine the extent to which tax delinquent persons received benefits from the Individuals and Households Program (IHP) operated by the Federal Emergency Management Agency (FEMA) following Hurricanes Katrina and Rita. IHP is a Federal direct assistance program authorized by the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act). GAO agreed to determine, to the extent practical, the estimated magnitude of Federal taxes owed by individuals receiving IHP disaster assistance benefit payments following Hurricanes Katrina and Rita; and provide examples of abusive or criminal activity related to the Federal tax system by IHP recipients with unpaid Federal taxes.

GAO conducted its estimate by cross referencing IRS tax debts in excess of \$100 as of September 30, 2005 with IHP disaster assistance benefit payments for Hurricanes Katrina and Rita. It found that about 80,000 of the 1.5 million individuals (about 5 percent) who received disaster assistance benefits for Hurricanes



Katrina and Rita owed over \$700 million in unpaid Federal taxes prior to those hurricanes. GAO reported that FEMA officials stated that they do not screen disaster applicants for existing tax debts because there is no legal requirement to do so.

GAO also presented five IHP recipient case histories of abusive and criminal activity. These recipients had tax debts ranging from about \$400,000 to over \$2 million, and several had a history of failing to file tax returns for several years prior to the hurricane disasters. GAO also identified instances in which IHP recipients attempted to transfer property to avoid IRS seizure. For example, one IHP recipient in the oil and gas industry had forged a third party's signature to illegally transfer land. Another IHP recipient, a lawyer, transferred a large quantity of stock to a family member while the IRS was taking collection actions against the lawyer.

*E. Medicare: Covert Testing Exposes Weaknesses in the Durable Medical Equipment Supplier Screening Process (GAO-08-955), July 3, 2008*

In connection with the Subcommittee's ongoing investigation into waste, fraud, and abuse in the Medicare and Medicaid programs, the Subcommittee asked GAO to examine vulnerabilities in Medicare's enrollment process for suppliers of durable medical equipment, prosthetics, orthotics, and supplies (DMEPOS). Due to weaknesses in the DMEPOS enrollment and inspection process, CMS has found that sham companies have been able to enroll in the program and fraudulently bill Medicare for unnecessary or nonexistent supplies. CMS has estimated that, from April 2006 through March 2007, Medicare has made \$1 billion in improper payments for DMEPOS supplies, in part due to fraud by the enrolled suppliers.

GAO tested CMS's processes by creating two fictitious DMEPOS suppliers, applying for Medicare billing numbers, and completing electronic test billings. GAO reported that it was able easily to establish two fictitious DMEPOS companies using undercover names and bank accounts. GAO reported that its fictitious companies applied for and were able to win approval for Medicare billing privileges despite having no clients or inventory. GAO reported that CMS had initially denied the applications in part because of a lack of inventory, but undercover GAO investigators then fabricated contracts with nonexistent wholesale suppliers to convince CMS and its contractor, the National Supplier Clearinghouse (NSC), that the companies had access to DMEPOS items.

As a result of these simple methods of deception, both fictitious DMEPOS companies obtained Medicare billing numbers. After requesting an electronic billing enrollment package and obtaining passwords from CMS, GAO was then able to successfully complete Medicare's test billing process for the Virginia office. GAO was unable to complete test billing for the Maryland office, however, because CMS has not sent the necessary passwords. However, if real criminals had been in charge of the fictitious companies, they would have been clear to bill Medicare for potentially millions of dollars worth of nonexistent supplies.

After concluding the test, GAO recommended that CMS and associated contractors initiate procedures beyond the current paper-

work reviews to conduct more rigorous oversight of DMEPOS suppliers to ensure their legitimacy.

*F. Premium Class Travel: Internal Control Weaknesses Governmentwide Led to Improper and Abusive Use of Premium Class Travel (GAO-07-1268), September 28, 2007*

In conjunction with its work to uncover waste, fraud, and abuse in the Federal Government, the Subcommittee has conducted an ongoing inquiry into problems with Federal travel programs and expenses. Previous GAO reports undertaken at the request of the Subcommittee disclosed improper premium class travel at the Department of Defense (DOD) and the Department of State (State). In this report, the Subcommittee asked GAO to examine whether similar improper travel existed in the rest of the Federal Government. In response, GAO undertook a study to determine the magnitude of premium class travel government-wide, and the extent to which such travel was improper; the existence of internal control weaknesses that contributed to improper and abusive premium class travel; and specific examples of improper and abusive premium class travel.

GAO found that Federal employees on official government travel were expected to follow published guidelines related to when and how premium (first and business) class travel should be undertaken. Due to the high cost of premium class travel, Federal Travel Regulations (FTR) issued by the General Services Administration (GSA) provide specific guidelines to restrict premium class use. GAO reported that, according to GSA data, the government fare for business class travel is typically more than 5 times the price of coach class travel for comparable routes, with some tickets costing more than 10 times as much.

GAO reported that the Federal Government spent over \$230 million on about 53,000 premium class tickets from July 1, 2005, through June 30, 2006. GAO determined that breakdowns in internal controls and a weak controlled environment resulted in at least \$146 million in improper first and business class travel government-wide. Based on statistical sampling, GAO estimated that 67 percent of premium class travel was not properly authorized, justified, or both. While business class travel accounted for 96 percent of all premium class travel, GAO found that many agencies did not track, and thus did not know the extent of, business class travel. GAO noted that Office of Management and Budget (OMB) and GSA also did not require reporting of business class travel. GAO also found large differences in premium class guidance government-wide, with some agencies issuing less restrictive guidance that were tailored for executive travel.

GAO made two recommendations to prevent improper premium travel. GAO recommended that agencies: (1) improve internal controls to properly authorize and justify premium class travel, including prohibiting subordinates or the travelers themselves from authorizing premium class travel, and (2) establish procedures to require compiling government-wide data and monitoring of the extent of premium class travel, including business class.

*G. Governmentwide Purchase Cards: Actions Needed to Strengthen Internal Controls to Reduce Fraudulent, Improper, and Abusive Purchases (GAO-08-333), March 14, 2008*

In conjunction with its work uncovering waste, fraud, and abuse in the Federal Government, the Subcommittee requested that GAO analyze credit card transactions at certain agencies to (1) determine whether internal control weaknesses existed in the government purchase card program; and (2) if so, identify examples of fraudulent, improper, and abusive activity. To conduct this review, GAO asked agencies to provide documentation on selected transactions to establish that the purchase had been properly authorized and that when the good or service was delivered, an individual other than the cardholder received and signed for it. Using a statistical sample of purchase card transactions from July 1, 2005, through June 30, 2006, GAO estimated that nearly 41 percent of the transactions failed to meet either of these basic internal control standards. Using a second sample of transactions over \$2,500, GAO found a similar failure rate—that agencies could not demonstrate that 48 percent of these large purchases met standards for proper authorization, independent receipt and acceptance, or both.

GAO also presented case studies showing how the breakdowns in these internal controls resulted in fraudulent, improper, or abusive purchase card use. These examples included instances in which government cardholders used government purchase cards to subscribe to Internet dating services, buy video iPods for personal use, and pay for lavish dinners. In one case, a cardholder used the government purchase card program to embezzle over \$642,000 over 6 years from the Department of Agriculture's Forest Service fire-fighting fund. This cardholder was sentenced to 21 months in prison and ordered to pay full restitution. GAO also determined that agencies were unable to locate 458 items of 1,058 total accountable and pilferable items totaling over \$2.7 million that GAO selected for testing. These missing items, which GAO considered to be lost or stolen, included computer servers, laptop computers, iPods, and digital cameras. For example, the Department of the Army could not adequately account for 256 items making up 16 server configurations, each of which cost nearly \$100,000.

*H. Information Security: Protecting Personally Identifiable Information (GAO-08-343), January 25, 2008*

In May 2006, a laptop computer containing the personal data of millions of veterans was stolen from the home of an employee of the Department of Veterans Affairs (VA). This incident raised a host of concerns regarding the security of personal information on Federal systems compromised by the loss or theft of equipment or by unauthorized access. The Subcommittee's Ranking Member Senator Coleman and Representative Susan Davis made a joint request that GAO: (1) identify the Federal laws and guidance issued to protect personally identifiable information from unauthorized use or disclosure; and (2) describe agencies' progress in developing policies and procedures under recent Office of Management and Budget guidance to protect personally identifiable information that is either accessed remotely or physically transported outside an agency's secured physical perimeter.

The loss of personally identifiable information can result in substantial harm, embarrassment, and inconvenience to individuals and may lead to identity theft or other fraudulent use of the information. Prior GAO evaluations had exposed weaknesses in the Federal Government's efforts to protect personally identifiable information. In this evaluation, GAO found that of the 24 major agencies, 22 had developed policies requiring personally identifiable information to be encrypted on mobile computers and devices. Fifteen of the agencies had policies to use a "time-out" function for remote access and mobile devices requiring user reauthentication after 30 minutes of inactivity. Eleven agencies had established policies to log computer-readable data extracts for databases holding sensitive information and erase the data within 90 days after extraction.

At the conclusion of GAO's review, OMB announced in November 2007, that agencies that did not complete certain privacy and security requirements had received a downgrade in their scores for progress in electronic government initiatives. According to OMB, it will continue working with agencies to help them strengthen their information security and privacy programs, especially as they relate to the protection of personally identifiable information.

*I. Combating Nuclear Smuggling: DNDO Has Not Yet Collected Most of the National Laboratories' Test Results on Radiation Portal Monitors in Support of DNDO's Testing and Development Program (GAO-07-347R), March 9, 2007*

As part of its effort to evaluate U.S. safeguards against nuclear and radiological threats, the Subcommittee has examined government efforts to prevent a nuclear weapon or radiological dispersal device (a "dirty bomb") from being smuggled into the United States. The Department of Homeland Security (DHS), through its Domestic Nuclear Detection Office (DNDO), has lead responsibility for conducting the research, development, testing, and evaluation of radiation detection equipment that can be used to detect smuggled nuclear or radiological materials. As of 2007, most of DNDO's work on radiation detection equipment has focused on the development and use of radiation detection portal monitors, which are larger-scale equipment that can screen vehicles, people, and cargo entering the United States. Current portal monitors, made of polyvinyl toluene plastic (PVTs), can detect the presence of radiation but cannot distinguish between benign radiological materials (NORM) such as ceramic tile, and dangerous materials such as highly enriched uranium (HEU). DNDO plans to replace PVTs with the next generation of portal monitors, known as Advanced Spectroscopic Portals (ASP), with the hope that ASPs will be able to more specifically identify radiological and nuclear materials within a shipping container. Given that this plan would require a multibillion dollar investment and coordination with State and local governments, the Subcommittee, the full Committee, the House Committee on Energy and Commerce, and the House Committee on Homeland Security made a joint request to GAO to assess the advantages and disadvantages of this planned approach.

GAO's report examined the extent to which DNDO has: (1) compiled previous test results from the national laboratories on com-

mercially available portal monitors, and (2) provided State and local authorities with information on the technical performance characteristics and operation of radiation detection equipment. GAO reported that DNDO was in the process of planning how to develop a database with PVT test reports to gauge how well they detect radiological and nuclear material and how environmental conditions and other factors may affect PVT performance. GAO reported that DNDO was also improving its efforts to provide technical and operational information about radiation portal monitors to State and local authorities. For example, DNDO recently helped to establish a Website that, among other features, includes information for State and local officials on radiation detection equipment products and performance requirements. GAO reported that some State representatives, particularly those from States with less experience conducting radiation detection programs, would like to see DNDO provide more prescriptive advice on what types of radiation detection equipment to deploy and how to use it.

*J. Nuclear Security: NRC and DHS Need to Take Additional Steps to Better Track and Detect Radioactive Materials (GAO-08-598), June 19, 2008*

As part of its effort to evaluate U.S. safeguards against nuclear and radiological threats, the Subcommittee has devoted resources to evaluating the government's ability to detect and track nuclear materials in the United States, including low-grade radioactive materials that could be used to build a "dirty bomb" a device using conventional explosives to disperse radioactive material. During the 110th Congress, the Subcommittee and the House Committee on Energy and Commerce made a joint request to GAO to assess certain policies and practices of the Nuclear Regulatory Commission (NRC) and Department of Homeland Security (DHS) related to tracking and detecting nuclear materials, including: (1) the NRC's progress in implementing recommendations, made by GAO in 2003, to strengthen U.S. capabilities in this area; (2) other steps the NRC has taken to improve its ability to detect and track nuclear materials; (3) the capability of the DHS Customs and Border Protection (CBP) to detect radioactive materials at land ports of entry, and (4) the capability of the CBP to verify that such materials were appropriately licensed prior to entering the United States.

GAO determined that NRC had implemented three of the six recommendations from GAO's 2003 report. GAO reported that the NRC had worked with the 35 States to which it has ceded primary authority to regulate radioactive materials to: (1) identify sealed sources (radioactive materials sealed in a capsule) of greatest concern; (2) enhance requirements to secure radioactive sources; and (3) ensure security requirements are implemented. GAO reported that, in contrast, NRC had made only limited progress toward implementing recommendations to: (1) modify its process for issuing licenses to ensure that radioactive materials cannot be purchased by those with no legitimate need for them; (2) determine how to effectively mitigate the potential psychological effects of malicious use of such materials; and (3) examine whether certain radioactive sources should be subject to more stringent regulations.



Beyond acting on GAO's recommendations, GAO reported that the NRC had taken four additional steps to improve its ability to track radioactive materials. First, NRC created an interim national database to monitor the licensed sealed sources containing materials that pose the greatest risk of being used in a dirty bomb. Second, NRC is developing a National Source Tracking System to replace that interim database and provide more comprehensive, updated information on potentially dangerous sources. GAO also reported, however, that this system has been delayed by 18 months and is not expected to be fully operational until January 2009. Third, NRC is developing a Web-Based Licensing System that will include more comprehensive information on all sources and materials that require NRC or State approval to possess. Finally, NRC is developing a license verification system that will draw information from the other new systems to enable officials and vendors to verify that those seeking to bring radioactive materials into the country or purchase them are licensed to do so. GAO noted, however, that the various systems are more than 3 years behind schedule and initially may not include the licensing information on radioactive materials regulated by Agreement States—which represent over 80 percent of all U.S. licenses for such materials. GAO reported that the delays in the development and deployment of these systems are especially consequential because NRC has identified them as key to improving the control and accountability of radioactive materials. Finally, GAO reported that, while the CBP has a comprehensive system in place to detect radioactive materials entering the United States at land borders, some equipment that is used to protect CBP officers is in short supply.

*K. Supply Chain Security: Examinations of High-Risk Cargo at Foreign Seaports Have Increased, but Improved Data Collection and Performance Measures Are Needed (GAO-08-187), January 25, 2008*

The Container Security Initiative (CSI) of the Customs and Border Protection (CBP) aims to identify and examine high-risk U.S.-bound cargo through inspections at foreign seaports. GAO reported in 2003 and 2005 that CSI helped to enhance homeland security, and recommended actions to strengthen the program. The Subcommittee, full Committee, the Senate Committee on Commerce and the House Committee on Energy and Commerce made a joint request to GAO to update its prior work and assess how CBP has: (1) contributed to strategic planning for supply chain security, (2) strengthened CSI operations, and (3) evaluated CSI operations.

GAO determined that CBP reached an important target of operating CSI in 58 foreign seaports, and thereby having 86 percent of all U.S.-bound cargo containers pass through CSI seaports in fiscal year 2007. Also, CBP has increased CSI staffing levels closer to those called for in its staffing model and in prior GAO recommendations. GAO reported, however, that CBP still faces staffing challenges because of its partial dependence on a temporary workforce and inability to identify sufficient numbers of qualified staff. Also, while CBP has been able to reach most foreign seaports, hurdles to cooperation remain at some of them, such as restrictions on CSI teams witnessing examinations. GAO reported that CBP re-

efined overall CSI performance measures, but has not fully developed performance measures and annual targets for core CSI functions, such as the examination of high-risk containers before they are placed on vessels bound for the United States. GAO concluded that these weaknesses in CBP's data collection and performance measures potentially limit the information available on overall CSI effectiveness.

*L. Supply Chain Security: U.S. Customs and Border Protection Has Enhanced Its Partnership with Import Trade Sectors, but Challenges Remain in Verifying Security Practices (GAO-08-240), April 25, 2008*

The Customs and Border Protection (CBP) is responsible for ensuring the security of cargo containers shipped into the United States. To strike a balance between security and commerce, CBP oversees the Customs-Trade Partnership Against Terrorism (C-TPAT) program. C-TPAT aims to secure the flow of goods bound for the United States by developing a voluntary antiterrorism partnership with stakeholders of the international trade community comprised of importers; customs brokers; air, sea, and land carriers; and other logistics service providers such as freight consolidators and nonvessel common carriers. Member companies agree to allow CBP to validate their security practices and, in exchange, they are awarded benefits, such as reduced scrutiny of their cargo. CBP gained additional responsibility for the C-TPAT program when the Security and Accountability For Every Port (or SAFE Port) Act of 2006 established a statutory framework for it and added new components to it.

A prior review by GAO of the C-TPAT program found multiple managerial and operational weaknesses. The Subcommittee, full Committee, Senate Committee on Commerce, and House Committee on Energy and Commerce made a joint request that GAO assess CBP's progress in overcoming those weaknesses, including progress in: (1) improving its benefit award policies for C-TPAT members, (2) addressing challenges in validating members' security practices, and (3) addressing management and staffing challenges.

GAO found that CBP had taken steps to improve the C-TPAT program, but challenges remained. GAO reported that CBP had strengthened its policies for granting benefits to importers, C-TPAT's largest member sector, but is working to improve its policies for members in other trade sectors. With regard to the C-TPAT security validation process, GAO reported that CBP was unable to verify that partnership members had security practices that met the minimum criteria. For example, CBP did not have internal controls to consistently ensure that when security specialists made recommendations in validation reports, appropriate actions were taken to follow up those recommendations. As a result, CBP could not be certain that the C-TPAT member companies who were shipping containers under reduced security agreements were using adequate security practices. Finally, GAO reported that CBP had embarked on plans to improve managing and staffing.

GAO made recommendations for specific improvements which CBP agreed to implement.

*M. Supply Chain Security: CBP Works with International Entities to Promote Global Customs Security Standards and Initiatives, but Challenges Remain (GAO-08-538), August 15, 2008*

As part of the responsibility of the Customs and Border Protection (CBP) to ensure the security of cargo containers shipped into the United States, CBP is involved with efforts to establish an international system of mutual recognition of customs security practices based on the adoption of uniform, international standards. The Subcommittee, full Committee, Senate Committee on Commerce, and House Committee on Energy and Commerce made a joint request to GAO to evaluate: (1) actions taken by CBP to develop and implement international supply chain security standards, (2) actions taken by CBP with international partners to achieve mutual recognition of customs security practices, and (3) issues CBP and foreign customs administrations anticipate in implementing 100 percent scanning of U.S.-bound container cargos.

GAO reported that, to develop and implement international supply chain security standards, CBP has taken a lead role in working with foreign customs administrations and the World Customs Organization (WCO). Through the Container Security Initiative (CSI), CBP places staff at foreign seaports to work with host nation customs officials to identify high-risk container cargo bound for the United States, and through the Customs-Trade Partnership Against Terrorism (C-TPAT), CBP forms voluntary partnerships to enhance security measures with international businesses involved in oceangoing trade with the United States. GAO reported that, in collaboration with 11 other members of the WCO, CBP has developed the Framework of Standards to Secure and Facilitate Global Trade (SAFE Framework). The SAFE Framework was adopted by the 173 WCO member customs administrations in June 2005; and as of July 2008, 154 had signed letters of intent to implement the standards. More specifically, CBP has signed mutual recognition arrangements with New Zealand, Jordan and Canada, and anticipates an agreement in 2009 with the European Commission, which represents the 27 member nations of the European Union.

GAO reported that recent U.S. laws, such as The Implementing Recommendations of the 9/11 Commission Act of 2007 (9/11 Act)—requiring that 100 percent of U.S.-bound container cargo be scanned at foreign seaports—may affect worldwide adoption of international standards. CBP and some foreign partners have stated that, unless additional resources are made available, 100 percent scanning could not be met. GAO reported that CBP and European custom administration officials have said that 100 percent scanning may result in a lower level of security if customs officers are diverted from focusing on high-risk container cargo. Under the current risk-management system, for example, the scanned images of high-risk containers are to be reviewed in a very detailed manner. However, according to WCO and industry officials, if all containers are to be scanned, the reviews may not be as thorough. Further, a European customs administration reported that 100 percent scanning could have a negative impact on the flow of commerce and also would affect trade with developing countries disproportionately.

*N. United Nations Organizations: Oversight and Accountability Could Be Strengthened by Further Instituting International Best Practices (GAO-07-597), June 18, 2007*

As part of the Subcommittee's ongoing investigation into United Nations management issues, the Subcommittee's Ranking Minority Member, Senator Coleman, and the House Committee on Foreign Affairs' Ranking Minority Member, Representative Ileana Ros-Lehtinen, asked GAO to examine the progress of the United Nations in implementing a range of management, oversight, and accountability reforms designed, in part, to ensure that resources are used effectively and efficiently. In particular, GAO examined the extent to which: (1) selected U.N. internal audit offices had implemented professional standards for performing audits and investigations; (2) selected U.N. evaluation offices had implemented U.N. evaluation standards; and (3) selected U.N. governing bodies were provided with information about the results of U.N. oversight practices.

GAO reported that the six U.N. internal audit offices reviewed had made progress in implementing international auditing standards, they had not fully implemented key components of the standards. GAO reported that the audit offices lacked completed organization wide risk-management frameworks, which are essential in identifying the areas with the greatest vulnerability to waste, fraud, and abuse, and three audit offices lacked sufficient staff to cover high-risk areas of the organization. GAO also reported that some of the audit offices had not fully implemented quality assurance processes, which include activities such as external peer reviews; and some did not have professional investigators.

GAO reported that the six U.N. evaluation offices reviewed were working toward implementation of U.N. evaluation standards, but had not fully implemented them. GAO reported that most of the evaluation offices lacked sufficient resources and expertise to manage and conduct evaluations, especially at the country level, which impacted their ability to conduct high-quality and strategically important evaluations. In addition, GAO reported that most of the evaluation offices had not fully implemented quality assurance processes relating to areas such as evaluation methodology, scope, evidence, and findings. GAO also reported that all of the evaluation offices were working toward fully establishing mechanisms that systematically follow up and report on the status of their recommendations.

GAO reported that the U.N. governing bodies responsible for oversight of the audit and evaluation offices lacked full access to internal audit reports and most lacked direct information from the audit offices about the sufficiency of their resources and capacity to conduct their work. GAO noted that access to that information would provide greater insights into the offices' operations and help identify critical systemic weaknesses. In addition, GAO reported that, with one exception, the audit committees that GAO examined were generally not accountable to their governing bodies, and some were composed of senior U.N. management officials.

*O. United Nations: Progress on Management Reform Efforts Has Varied (GAO-08-84), November 14, 2007*

As part of the Subcommittee's ongoing investigation into United Nations management issues, the Subcommittee asked GAO to update a 2006 GAO report which had found that United Nations management reforms were progressing slowly. In response, GAO evaluated U.N. management reform initiatives in five areas—ethics, oversight, procurement, management operations of the Secretariat, and management of U.N. programs and activities (known as mandates); and also identified factors that had slowed the pace of reform efforts.

Overall, GAO found mixed progress in U.N. management reform efforts. In the area of ethics, GAO found that the U.N. Ethics Office had made substantial progress in staffing its office and implementing a whistleblower protection policy, as well as some progress in developing ethics standards and collecting and analyzing financial disclosure forms. In the area of oversight, GAO found that member states had made some progress when they created an Independent Audit Advisory Committee, which is expected to be operational by January 2008. Additionally, the Office of Internal Oversight Services (OIOS) had improved the oversight capacity of individual divisions, including through internal audit and investigations. GAO noted, however, that U.N. funding arrangements continue to constrain the independence of OIOS and its ability to audit high-risk areas.

In the area of procurement, GAO found that some progress had been made, noting the development of a comprehensive training program for procurement staff. GAO also noted, however, that the U.N. had made little or no progress in establishing an independent bid protest system. GAO found that some progress had been made in reforming management operations at the U.N. Secretariat, highlighting improvements to human resource functions and information technology. In contrast, GAO found little or no progress had been made in reforming the U.N.'s internal justice system for resolving and adjudicating staff grievances and safeguarding the rights of staff members, certain budgetary and financial management functions, and the delivery of certain services. Finally, GAO found that, despite some limited initial actions, the U.N.'s review of U.N. programs and activities had not advanced, due in part to a lack of support by many member states.

GAO reported that various factors had slowed the pace of U.N. management reforms, and predicted that a number of reforms would be unable to move forward until those factors were addressed. GAO identified four main factors slowing reforms: (1) disagreements among member states on the priorities and importance of U.N. management reform efforts, (2) the lack of comprehensive implementation plans for some management reform proposals, (3) administrative policies and procedures that continue to complicate the process of implementing certain complex human resource initiatives, and (4) competing U.N. priorities, such as the proposal to reorganize the Department of Peacekeeping Operations, that limit the capacity of General Assembly members to address management reform issues.



*P. Selected Agencies Use of Criminal Background Checks for Determining Responsibility (GAO-07-215R), January 12, 2007*

As part the Subcommittee's ongoing interest in uncovering and preventing contractor waste and fraud affecting the Federal Government, the Subcommittee asked GAO to research certain agency policies and practices for making responsibility determinations before awarding contracts, including any agency use of criminal background checks. Responsibility determinations for Federal contractors include an assessment of a number of specific elements including a contractor's technical capability, past performance, financial capability, and business ethics and integrity. In its report, GAO sought to (1) identify agency policies and practices for making contractor responsibility assessments, and the conditions under which agencies conduct criminal background checks; (2) determine how contracting officers use the Excluded Parties List System (EPLS) to make responsibility assessments and identify any planned improvements to the EPLS; and (3) determine the number of fraud investigations in which the contractor or its principals had a prior criminal background.

GAO found that Federal agencies base their policies and practices for making contractor responsibility determinations on the Federal Acquisition Regulation (FAR) and their own supplements to the FAR. The FAR specifies a number of factors to consider in making responsibility determinations, but does not require a criminal background check. GAO reported that contracting officers also used the EPLS system to determine if a particular contractor was excluded from eligibility to bid on a contract. GAO reported that contracting officers said they generally searched the EPLS by using (1) an identifying number such as the Data Universal Numbering System (DUNS) or a Taxpayer Identification Number, or (2) the name of either the firm or an individual.

GAO described how the EPLS list was compiled. GAO reported that officials said their agencies received allegations of irregularities from many sources including contracting officers, oversight organizations such as the Defense Contract Management Agency, agency or contractor employees, competitors, other Federal agencies, whistleblower cases, and hotlines. Agencies assigned investigations of fraud to internal criminal investigative units, such as the Office of Inspector General, which coordinate with their General Counsel offices to report indictments or evidence to initiate suspensions and convictions to initiate debarment proceedings.

GAO reported that, according to agency officials, information on whether investigations included company employees or principals with a prior criminal history may be contained in the case files if it is a part of the information collected in developing the investigation. For example, at DOJ, prior criminal history checks are a routine part of case development. However, the case files are narrative in nature and, therefore, obtaining the information would require a case-by-case analysis. GAO was thus unable to determine the number of fraud investigations in which the contractor or its principals had a prior criminal background.

*Q. Terrorist Watch List Screening: Opportunities Exist to Enhance Management Oversight, Reduce Vulnerabilities in Agency Screening Processes, and Expand Use of the List (GAO-08-110) October 11, 2007*

The Terrorist Screening Center (TSC) of the Federal Bureau of Investigation (FBI) maintains a consolidated watch list of known or suspected terrorists and sends records from the list to agencies to support terrorism-related screening. Because the list is an important tool for combating terrorism and because there have been complaints and criticisms about its effectiveness, the Subcommittee, the full Committee, and the House Committee on Homeland Security made a joint request to GAO to examine: (1) the standards for including individuals on the list, (2) the outcomes of encounters with individuals on the list, (3) potential vulnerabilities and efforts to address them, and (4) actions taken to promote effective terrorism-related screening.

To conduct this work, GAO reviewed documentation obtained from and interviewed officials at TSC, the FBI, the National Counterterrorism Center, the Department of Homeland Security (DHS), and other agencies that perform terrorism-related screening. GAO found that the FBI and intelligence community use standards of reasonableness to evaluate individuals for nomination to the consolidated watch list. GAO reported that agencies generally list individuals with known links to terrorism as well as individuals who are reasonably suspected of having possible links to terrorism. Because the list includes individuals with possible, but not known, links to terrorism, being on the list does not automatically prohibit the issuance of a visa or entry into the United States. Instead, agency officials are required to assess the threat that a particular person poses to determine what action to take, if any.

GAO reported that, as of May 2007, the consolidated watch list contained approximately 755,000 records. GAO found that, from December 2003 through May 2007, screening and law enforcement agencies encountered individuals who were positively matched to watch list records approximately 53,000 times. Many of the same individuals were matched multiple times. The encounters resulted in a wide array of actions, including arrests, denials of entry into the United States, and, most often, questioning and release. GAO reported that, within the Federal community, there is general agreement that the watch list has helped to combat terrorism by (1) providing screening and law enforcement agencies with information to help them respond appropriately during encounters, and (2) helping law enforcement and intelligence agencies track individuals on the watch list and collect information about them for use in conducting investigations and in assessing threats.

Regarding potential vulnerabilities, GAO reported that TSC sends records daily from the watch list to screening agencies. GAO noted, however, that some records are not sent, partly because screening against them may not be needed to support the respective agency's mission or may not be possible due to the requirements of various computer programs used to check individuals against watch list records. GAO reported that some listed persons had passed undetected through agency screening processes and were not identified, for example, until after they had boarded and

flew on an aircraft or were processed at a port of entry and admitted into the United States. TSC and other Federal agencies have ongoing initiatives to help reduce these potential vulnerabilities, including efforts to improve computerized name-matching programs and the quality of watch list data.

GAO reported that, although the Federal Government has made progress in promoting effective terrorism-related screening, additional screening opportunities remain untapped within both the Federal and private sectors. GAO found that the government lacked an up-to-date strategy and implementation plan for optimizing use of the terrorist watch list, and clear lines of authority and responsibility. GAO concluded that an up-to-date strategy and implementation plan, supported by a clearly defined leadership or governance structure, would provide a platform to establish government-wide screening priorities, address privacy and civil liberties issues, identify problems, implement reforms, and assess progress.

*R. Additional GAO reports that assisted the Subcommittee during the 110th Congress include the following, which have already been described in connection with the Subcommittee's hearings.*

- Thousands of Medicaid Providers Abuse the Tax System (GAO-08-17), November 14, 2007
- Medicare: Thousands of Medicare Providers Abuse the Federal Tax System (GAO-08-618), June 13, 2008
- Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes (GAO-08-617), July 27, 2008

*S. Additional GAO reports that assisted the Subcommittee during the 110th Congress include the following, which were requested by multiple parties and which lie within the primary jurisdiction of other committees.*

- Nuclear Nonproliferation: Progress Made in Improving Security at Russian Nuclear Sites, but the Long-term Sustainability of U.S.-Funded Security Upgrades Is Uncertain (GAO-07-404), February 28, 2007
- Oil and Gas Royalties: Royalty Relief Will Cost the Government Billions of Dollars but Uncertainty Over Future Energy Prices and Production Levels Make Precise Estimates Impossible at this Time (GAO-07-590R), April 12, 2007
- Global Nuclear Energy Partnership: DOE Should Reassess Its Approach to Designing and Building Spent Nuclear Fuel Recycling Facilities (GAO-08-483), April 22, 2008