

An Examination of Fraud and Corruption within the Industry of Oil and Gas

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ABSTRACT

Given the large amounts of investments in and revenues generated from oil and gas operations and the extremely technical nature of work which requires specific skills and education the industry is filled with situations which create the opportunity for fraud. The purpose of this paper is to discuss three areas of fraud and corruption within the oil and gas industry; investment scams, conflict of interest and tribal severances.

INTRODUCTION

Following federal taxation, annual royalties earned from the oil and gas industry are the United States federal government's second leading source of income. In the fiscal year of 2007 the Department of the Interior's Minerals Management Services (MMS) collected approximately \$9.4 billion from oil and gas royalties, of which \$6.7 billion represented non-tax income for the federal government [3]. Such a large percentage of income received by one area leads to a greater possibility of fraudulent scams associated with revenues.

According to the Association of Certified Fraud Examiners 2008 Report to the Nation on Occupational Fraud and Abuse the greatest percentage of corruption cases occurred in the oil and gas industry; additionally 17 cases of financial statement fraud were reported by oil and gas companies [1].

INVESTMENT SCAMS

Increased gas prices have created a heightened interest in oil and gas investment opportunities. The reasoning being simple; a higher price per barrel of oil equals a larger portion of royalty income in the investor's wallet. Investors also are attracted to the possible ongoing cash stream that is received by owning many interests. While some wells "blow out" millions of gallons and dissipate after a short period of time, others produce for many years creating a long period of received oil checks.

Investment scams are currently the largest fraction of fraud within the oil and gas industry. Some may be tricked into investing their money into non-existent companies, or existing companies with overpriced stocks. Actual companies may have padded invoices, meaning they over-exaggerate actual costs related to each venture.

CONFLICTS OF INTEREST

In 2008 the Interior Department released reports detailing unprofessional conduct and a lack of independent between the Mineral Management Service (MMS) and the oil and gas companies it regulated. The report specifically focused on the branch of the MMS located in Lakewood, Colorado. The employees rigged contracts, worked part time as private oil consultants, accepted trips and dinners from oil and gas executives in addition to having sexual relationships with them, the reports allege.

One of the first concerns was that this branch functioned in part like a business, collecting “royalty-in-kind” payments (as in actual oil and gas rather than cash), and proceeding to sell this oil and gas on the open market creating a competition with private sectors of the industry. In 2009 the government received \$4.9 billion in “royalty-in-kind” payments.

Second, the MMS was accused of unethical behavior consisting from sex with company representatives, kickbacks, and drug abuse. Nine employees allegedly received thousands of dollars and gifts (ski and golf trips, concert tickets, etc.), two of the workers accepting over one-hundred gifts from four large companies that did business with the office in Lakewood – Shell, Chevron Corp., Hess Corp, and Gary-Williams Energy Corporation [2].

TRIBAL SEVERANCE

The 1989 report of the Committee on Investigations of the Senate Select Committee on Indian Affairs noted that fraud, corruption and mismanagement of Indian natural resources had not significantly lessened during the 1980s. As a result, tribes had lost many more millions of dollars in revenue from their non-renewable natural resource base.

In 1996 a lawsuit was filed against the United States Department of the Interior. The case has encompassed dozens of hearings, 192 days of trial proceedings and multiple appeals to higher courts. On December 8, 2009 the Obama administration said it would pay \$1.4 billion to a group of American Indians in settlement of the case. The settlement will be divided among more than 300,000 descendants of Indians to whom the government assigned plots of tribal land under the 1887 law.

SELECTED REFERENCES

[1] Association of Certified Fraud Examiners (ACFE Report). (2008). *Report to the Nation on Occupational Fraud & Abuse*.

[2]Chakrabarty, G. (2008, September 10), Federal officials in Colo. accused of drug use, sex with oil execs. *Rocky Mountain News*.

[3] United States Government Accountability Office (GAO, 2008). Oil and Gas Royalties: MMS’s Oversight of Its Royalty-in-Kind Program Can Be Improved through Additional Use of Production Verification Data and Enhanced Reporting of Financial Benefits and Costs. 26 September 2008. <http://www.gao.gov/new.items/d08942r.pdf>