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Briefing Report to the Chairman, Subcommittee on Environment, Energy, and Natural Resources, Committee on Government Operations, House of Representatives

September 1989

TENNESSEE VALLEY AUTHORITY

Special Air Transportation Services Provided to Manager of Nuclear Power

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September 25, 1989

The Honorable Mike Synar
Chairman, Subcommittee on Environment,
Energy, and Natural Resources
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

This briefing report responds to your request that we examine several aspects of the Tennessee Valley Authority's (TVA) arrangement to provide special air transportation services to Mr. Steven A. White during his tenure as TVA's Manager of Nuclear Power. You asked about the purpose, the nature, and the costs of the air transportation services, and whether the benefits Mr. White received were potentially subject to federal income taxes. We have briefed the Subcommittee on the results of our work, and, as you requested, this report summarizes the information provided at that briefing.

BACKGROUND

Faced with a crisis in its nuclear power program, TVA sought outside management assistance in late 1985. On January 3, 1986, TVA contracted, through an intermediary firm, for the services of Mr. White, a retired U.S. Navy Admiral with extensive service in the Navy's nuclear submarine program. Mr. White served as TVA's Manager of Nuclear Power under various contract arrangements until November 18, 1988.

In two legal opinions[1] and one other report[2] we have addressed issues related to the arrangements under which Mr. White's management services were obtained by TVA and the manner in which TVA compensates its top managers.

RESULTS IN BRIEF

TVA spent $172,700 to provide Mr. White air transportation services between his TVA office in Chattanooga, Tennessee, and his home in Charlottesville, Virginia, between October 2, 1987, and September 30, 1988, when the arrangement ceased. Mrs. White accompanied Mr. White on three flights during this period. TVA provided the air transportation as a part of its management services contract with Mr. White's personal services corporation, STEMAR, through a combination

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[1]B-222334, June 2, 1986; B-222334.4, Apr. 4, 1989.

[2]TVA Management: Information on Compensation for Top Managers (GAO/RCED-89-137BR, May 17, 1989).

of (1) an arrangement with one of its major construction contractors, Bechtel North American Power Corporation, (2) its owned and leased aircraft, and (3) aircraft it chartered from the commercial sector. The air transportation was provided as an incentive to retain Mr. White's services because TVA's Board of Directors became concerned that his absence from his Charlottesville home would adversely affect his continued availability to TVA.

Of the $172,700 TVA spent for the special air transportation arrangement, $126,500 was for the cost of home-to-work transportation services provided directly to Mr. White and, in three instances, to Mrs. White. We believe that the fair market value of those services--not necessarily the $126,500 that TVA paid for them--could be considered taxable compensation to the Whites. The Internal Revenue Service is, however, the only agency that can make such a determination. It has special rules for computing the fair market value of aircraft flights received as fringe benefits. We do not know how this matter was treated by the Whites or by the STEMAR Corporation for federal income tax purposes.

APPROACH

To respond to the Subcommittee's questions concerning the purpose, the nature, the costs, and other aspects of TVA's special commuting arrangement for Mr. White, we reviewed contracts and related documents, including those providing for obtaining Mr. White's services, aircraft flight logs, passenger lists, cost reports, and invoices, and discussed the special air transportation arrangement with TVA officials. In evaluating the potential taxability of Mr. White's home-to-work transportation benefits, we researched and analyzed TVA's contracts for the services, relevant sections of the Internal Revenue Code, and Internal Revenue Service regulations. Appendix I contains additional details on our objectives, scope, and methodology and on TVA's special air transportation arrangement for Mr. White.

AGENCY COMMENTS

As agreed with the Subcommittee, we did not obtain official comments from TVA or from Mr. White on this report. However, we obtained much of the information in the report directly from TVA and incorporated the views of its officials where appropriate. In addition, we informed Mr.

White of our opinion that the fair market value of the home-to-work air transportation he received from TVA could be subject to federal taxation.

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As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this briefing report until 30 days from the date of this letter. At that time, we will provide copies to TVA, STEMAR, and Mr. White and to other interested parties upon request.

If you have questions about this report, please call me at 275-8676. GAO staff members who made major contributions to it are listed in appendix II.

Sincerely yours,

L. Nye Stevens

L. Nye Stevens
Director, Government Business
Operations Issues

CONTENTS

ABBREVIATIONS

IRS	Internal Revenue Service
NRC	Nuclear Regulatory Commission
TVA	Tennessee Valley Authority

SPECIAL AIR TRANSPORTATION SERVICES FOR TVA'S MANAGER OF NUCLEAR POWER

Chairman Mike Synar of the House Government Operations Committee's Subcommittee on Environment, Energy, and Natural Resources requested that we examine the Tennessee Valley Authority's (TVA) management and use of its passenger-carrying aircraft. In connection with that work, the Subcommittee asked that we also examine TVA's arrangement to provide Mr. Steven A. White, Manager of Nuclear Power, with air transportation between his office in Chattanooga, Tennessee, and his home in Charlottesville, Virginia.

At the Subcommittee's September 28, 1988, oversight hearing on the management of civilian agency aircraft, we testified on the results of our ongoing examination of these special air transportation services. The Subcommittee subsequently asked that we obtain additional information on this matter and provide it in this briefing report.

BACKGROUND

In the fall of 1985, TVA faced a crisis in its nuclear power program. By September, TVA had shut down its 5 operating reactors and halted or abandoned construction on 12 additional reactors. Extensive criticism from the Nuclear Regulatory Commission (NRC), Congress, and within TVA traced the roots of the crisis to a lack of effective management. As concern mounted that TVA would lose its NRC licenses to construct and operate nuclear reactors, NRC demanded that TVA take steps to improve the management of its nuclear power program.

In response to this situation, on January 3, 1986, TVA contracted with Stone and Webster Engineering Corporation, Boston, Massachusetts, for certain nuclear management services, including the services of Mr. Steven A. White, at a cost of $355,200 annually, to be its Manager of Nuclear Power. Under this contract, Mr. White was to provide direct management of TVA's nuclear power program for the 2-year period of January 13, 1986, to January 12, 1988. Mr. White's services were provided to Stone and Webster through his personal services corporation, STEMAR, located in Charlottesville, Virginia.

In a June 2, 1986, advisory opinion to the Chairwoman, Subcommittee on Civil Service, House Committee on Post Office and Civil Service (B-222334), our office concluded that TVA's management contract for Mr. White's services was improper because it was a personal services contract and the compensation level circumvented the statutory ceiling on salary payments to TVA employees, which was $72,300 at that time. However, our advisory opinion was not legally binding on TVA, and TVA continued the contractual arrangement for Mr. White's services at the same compensation level.

On January 7, 1987, TVA modified its contract with Stone and Webster Engineering Corporation and contracted directly with STEMAR, at the same compensation level, for Mr. White's management services through January 12, 1988. On January 2, 1988, TVA extended its contract with STEMAR for Mr. White's services for an additional year to January 12, 1989.

TVA amended the STEMAR management services contract on October 2, 1987, to provide Mr. White air transportation service, at TVA's expense, from his office in Chattanooga, Tennessee, to his home in Charlottesville, Virginia. Before this contract amendment, Mr. White used regular commercial airline service between these locations, and TVA reimbursed him for his out-of-pocket costs.

OBJECTIVES, SCOPE, AND METHODOLOGY

As agreed with the Subcommittee, our overall objective was to examine TVA's arrangement to provide Mr. White air transportation between his office in Chattanooga, Tennessee, and his home in Charlottesville, Virginia. Specifically, the Subcommittee asked us to determine

-- the purpose and costs of the commuting arrangement,

-- how and to what extent TVA provided such commuting services to Mr. White,

-- whether TVA provided similar commuting services to other regular or contract employees,

-- whether Mr. White incurred federal income tax liability resulting from those special home-to-work transportation benefits, and

-- TVA's rationale for terminating Mr. White's management contract before its scheduled expiration date.

We made our review between April 1988 and June 1989 and in accordance with generally accepted government auditing standards. Our field work was done in TVA's offices in Knoxville and Chattanooga, Tennessee. Research on Mr. White's potential tax liability was done in Washington, D.C.

In carrying out our work, we reviewed the management services contract between TVA and Stone and Webster Engineering Corporation dated January 3, 1986, and contract modification dated March 14, 1986; the contract between TVA and STEMAR Corporation dated January 7, 1987; and modifications to the STEMAR Corporation contract dated October 2, 1987, and January 2, 1988, which provided air transportation to Mr. White at TVA's expense. We also reviewed a contract TVA awarded to Bechtel North American Power Corporation on September 30, 1987, to provide air transportation services between Gaithersburg, Maryland, and Knoxville, Tennessee, with provision for additional stops at Chattanooga, Tennessee, and Huntsville, Alabama, and billing invoices and flight logs for services under that contract. Additionally, we discussed these matters with responsible TVA and Bechtel officials.

To determine the extent and costs of TVA's use of its aircraft and chartered aircraft to provide air transportation service to Mr. White, we analyzed aircraft flight reports, passenger lists, requests for passenger service, monthly operating cost reports, special flight cost comparison sheets, and charter aircraft flight records and invoices. We also reviewed and discussed with responsible TVA officials the contracts between TVA and charter airline companies that provided services.

To determine whether TVA paid for Mr. White's air transportation prior to the October 2, 1987, contract amendment; whether TVA provided similar commuting services to other regular or contract employees; and the reason Mr. White's management services contract was terminated before its scheduled expiration date, we reviewed pertinent TVA travel, flight, accounting, and contract records and obtained TVA's official position on these matters.

To address the taxability of the special air transportation services to Mr. White, we researched TVA's contractual arrangement for those services, the Internal Revenue Code, and the Internal Revenue Service's (IRS) income tax regulations.

AIR TRANSPORTATION SERVICES PROVIDED

TVA provided Mr. White special air transportation services between his office in Chattanooga, Tennessee, and his home in Charlottesville, Virginia, from October 2, 1987, through September 30, 1988, at a total cost of $172,700. TVA provided this service to Mr. White through a contract with Bechtel, one of its major construction contractors; with its owned and leased aircraft; and with aircraft it chartered from the commercial sector. According to TVA officials, TVA's Board of Directors decided to provide these services because it believed Mr. White's long-term absences from his home in Charlottesville, Virginia, would adversely affect his continued availability to TVA. The Board believed that the special transportation services were necessary to retain Mr. White's management services.

Transportation Initially Provided Through a TVA Contractor

Between October 2, 1987, and March 18, 1988, TVA furnished air transportation to Mr. White through a contract with Bechtel at a total direct cost to TVA of $108,400. Bechtel provided regular air transportation service with a chartered aircraft for its employees, TVA employees, other contractors' employees, and Mr. White.

Bechtel's prime contract with TVA provided that TVA would reimburse Bechtel for the cost of air transportation for Bechtel employees once each month or at any time if the trips were work-related. Bechtel received major TVA contracts in April and May 1987, and its travel requirements to TVA project locations grew as those projects got underway. During this period, Bechtel studied the possibility of obtaining regular charter service to transport its employees from its office near Gaithersburg, Maryland, to Knoxville and Chattanooga, Tennessee, and to other TVA project sites. However, Bechtel's analyses showed that charter flights were more economical than routine commercial flights only if the majority of the passenger seats were occupied on a continuing basis. In August 1987, Bechtel concluded that its travel requirements alone did not justify establishing a regular charter service from its Gaithersburg office to Knoxville, Chattanooga, and other TVA project sites.

At the same time, TVA was considering ways to provide air transportation services to Mr. White. TVA management reasoned that an aircraft chartered by Bechtel to meet its own travel requirements could also be used for transporting Mr. White and TVA regular and other contract employees who traveled on official business to the Washington, D.C., area.

As a result, on September 30, 1987, TVA entered into a contractual arrangement with Bechtel whereby Bechtel would provide an eight-passenger aircraft, and TVA would pay directly for four seats on each flight and indirectly for the remaining four seats through other contracts with Bechtel. According to TVA officials and the Bechtel project manager, TVA agreed to pay directly for four of the eight seats to accommodate Mr. White and to make charter aircraft services a cost-effective option for Bechtel.

Under the terms of the contract, Bechtel was to provide regular, twice weekly round-trip direct air transportation on a base route between Gaithersburg, Maryland, and Knoxville, Tennessee. Depending on TVA and Bechtel requirements, Bechtel also would make arrangements for flights to Chattanooga, Tennessee, and/or Huntsville, Alabama. Further, at TVA's request, Bechtel would arrange for stops at locations reasonably close to the base flight route. Geographically, Charlottesville, Virginia, is reasonably close to the base flight route. Bechtel contracted with Majestic Air Service, Chevy Chase, Maryland, to provide charter air transportation service, as outlined in its contract with TVA.

Majestic's flight logs showed that Mr. White was a passenger on 34 of 39 flights during the 5-1/2-month period ending March 18, 1988, when the last flight was made. Mrs. White accompanied Mr. White on three of these flights; the passenger list identified her as a STEMAR representative on two flights and simply as Mrs. White on the other flight. While TVA's direct share of the costs for all 39 flights was $108,400, $62,200 of that amount represented costs specifically attributable to Mr. or Mrs. White. The other $46,200 TVA paid represents the costs for other TVA contract officials or employees and the five flights that were made without Mr. White.

Flight records showed that TVA employees did not routinely travel on the Bechtel aircraft; only 19 seats were occupied by TVA employees on the 39 flights. The records also show that the Bechtel aircraft did not fly on a routine basis without Mr. White. The flight logs showed, and the Bechtel project manager confirmed, that the flights were geared to meet the needs of Mr.

White's schedule. These flights were made primarily on Friday evenings and Monday mornings so that Mr. White could get home to Charlottesville for the weekend and return to Chattanooga for work.

Bechtel employees occupied a total of 141 passenger seats on the 39 flights. According to the Bechtel project manager, Bechtel employees were being transported between its office in Gaithersburg, Maryland, and various TVA project locations. Transportation costs for these Bechtel employees were indirectly charged to TVA in accordance with the terms of various contracts.

TVA terminated its contract with Bechtel for aircraft services as of March 27, 1988. According to TVA officials, experience with flight arrangements under the Bechtel contract made it apparent that neither TVA nor Bechtel was using the service as much as had been anticipated, and thus the arrangement was uneconomical and was discontinued. Bechtel, in turn, canceled its regular charter service with Majestic Air Service. According to Bechtel's project manager, its travel requirements alone could not justify retention of regular charter service.

Air Transportation Provided With TVA and Chartered Aircraft

Upon terminating its contract with Bechtel in March 1988, TVA began using its owned or leased eight-passenger Beechcraft King Air aircraft, and aircraft it chartered from the commercial sector to transport Mr. White between Chattanooga and Charlottesville. During the 6-month period from April 1, 1988, through September 30, 1988, when the arrangement ceased, Mr. White made 23 flights between Chattanooga and Charlottesville, which cost TVA $64,300. Flight logs showed that Mr. White was the only passenger on these flights. TVA used its owned or leased aircraft for 17 of the 23 flights. Using the flight logs and TVA's most recent cost-per-flying-hour rate for the King Air aircraft, we calculated that TVA spent $50,900 for the 17 flights transporting Mr. White between Chattanooga and Charlottesville. TVA used commercial charter services for the remaining six flights, which cost TVA $13,400 according to vendor invoices.

TAXABILITY OF THE SPECIAL AIR TRANSPORTATION BENEFITS

As discussed earlier, TVA provided air transportation benefits to Mr. White through a contract with STEMAR, Mr. White's personal services corporation. Since STEMAR provided Mr. White's services, presumably he was its employee.

IRS income tax regulations provide that fringe benefits must be treated as taxable income if received directly or indirectly for services rendered by an employee, independent contractor, or partner. When services are received in exchange for services rendered, the fair market value of the services received is taxable as compensation. The cost of commuting to and from work is a personal expense that cannot be deducted. When an individual receives commuting services, the fair market value of the commuting services must be treated as a taxable fringe benefit.

The fair market value of any personal flights taken by employees on aircraft provided by the employer must also be treated as income to the employee. Additionally, the fair market value of flights provided to guests of employees is taxable. The income tax regulations provide special methods for computing the value of the flights.

Of the $172,700 TVA spent for the special air transportation arrangement, the home-to-work services provided to Mr. White and, on three flights, to Mrs. White, cost $126,500; the remaining $46,200 was for seats TVA paid for that were unoccupied or that were occupied by TVA or contract employees other than Mr. or Mrs. White.

Under the tax principles outlined above, we believe that the fair market value of the home-to-work transportation services that TVA provided to the Whites, not necessarily the $126,500 TVA paid for the air transportation, could be considered taxable compensation to the Whites. However, only IRS can make such a determination, and it has special rules for computing the fair market value of flights that are considered taxable fringe benefits. We do not know how this matter was treated by the Whites or by the STEMAR Corporation for federal income tax purposes.

COMMERCIAL AIR SERVICES PROVIDED BEFORE OCTOBER 1987

Before amending the management services contract to provide air transportation service, TVA reimbursed Mr. White for his out-of-pocket costs in commuting between Chattanooga, Tennessee, and Charlottesville, Virginia, on regular commercial flights in conjunction with official travel to and from Washington, D.C.. During the 21-month period from January 13, 1986, through October 8, 1987, Mr. White made 11 official trips from Chattanooga to Washington, D.C.. On 7 of the 11 trips, Mr. White returned to Chattanooga through Charlottesville, and TVA reimbursed him for those costs.

SIMILAR COMMUTING ARRANGEMENT NOT PROVIDED TO OTHERS

According to TVA officials, TVA did not routinely provide special air transportation services to its employees or to employees of its contractors. Those officials said there are numerous contracts under which TVA reimburses contractor personnel for air travel expenses between TVA work sites and the contractor's home office. However, TVA does not provide or arrange for the air transportation service under these contracts. On the basis of our review of TVA's aircraft flight documentation, we found no evidence that TVA provided similar commuting services to its employees or to contractors.

TERMINATION OF EMPLOYMENT CONTRACT

According to a TVA management official, Mr. White's management services contract was terminated before the scheduled expiration date of January 12, 1989, because TVA hired a replacement for Mr. White and STEMAR exercised its contractual right to terminate the contract. This official said that when Mr. White's contract expired in January 1988, it was extended for an additional year in anticipation that TVA would be successful in hiring a qualified replacement as a TVA employee. On September 6, 1988, TVA hired a replacement for Mr. White. On that same day, STEMAR notified TVA that it desired to terminate the contract. Subsequently, the contact was terminated, and Mr. White's employment arrangement with TVA ended on November 18, 1988.

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