September 11, 2008 Sex, Drug Use and Graft Cited in Interior Department By CHARLIE SAVAGE

WASHINGTON—As Congress prepares to debate expansion of drilling in taxpayer-owned coastal waters, the Interior Department agency that collects oil and gas royalties has been caught up in a wide-ranging ethics scandal—including allegations of financial self-dealing, accepting gifts from energy companies, cocaine use and sexual misconduct.

In three reports delivered to Congress on Wednesday, the departments inspector general, Earl E. Devaney, found wrongdoing by a dozen current and former employees of the Minerals Management Service, which collects about $10 billion in royalties annually and is one of the governments largest sources of revenue other than taxes.

“A culture of ethical failure” pervades the agency, Mr. Devaney wrote in a cover memo.

The reports portray a dysfunctional organization that has been riddled with conflicts of interest, unprofessional behavior and a free-for-all atmosphere for much of the Bush administrations watch.

The highest-ranking official criticized in the reports is Lucy Q. Denett, the former associate director of minerals revenue management, who retired earlier this year as the inquiry was progressing.

The investigations are the latest installment in a series of scathing inquiries into the programs management and competence in recent years. While previous reports have focused on problems the agency had in collecting millions of dollars owed to the Treasury, and hinted at personal misconduct, the new reports go far beyond any previous study in revealing serious concerns with the integrity and behavior of the agencys officials.

In one of the new reports, investigators concluded that Ms. Denett worked with two aides to steer a lucrative consulting contract to one of the aides after he retired, violating competitive procurement rules.

Two other reports focus on “a culture of substance abuse and promiscuity” in the services royalty-in-kind program. That part of the agency collects about $4 billion a year in oil and gas rather than cash royalties.

Based in suburban Denver and modeled to operate like a private sector energy company, the decade-old royalty-in-kind program sells oil and gas on the open market. Its employees are subject to government ethics rules, such as restrictions on taking gifts from people and companies with whom they conduct official business.

One of the reports says that the officials viewed themselves as exempt from those limits, indulging themselves in the expense-account-fueled world of oil and gas executives.

The reports provoked immediate outrage in Congress. Senator Ron Wyden, an Oregon Democrat who is chairman of the Public Lands and Forests Subcommittee, accused the Minerals Management Service on the Senate floor Wednesday of “a pattern of abuses and mismanagement” that is costing taxpayers billions.

And Senator Bill Nelson, Democrat of Florida, suggested that Congress should not lift its ban on offshore drilling—a hot-button issue in his state—because of the problems identified.

The report says that eight officials in the royalty program accepted gifts from energy companies whose value exceeded limits set by ethics rules—including golf, ski and paintball outings; meals and drinks; and tickets to a Toby Keith concert, a Houston Texans football game and a Colorado Rockies baseball game.

The investigation also concluded that several of the officials “frequently consumed alcohol at industry functions, had used cocaine and marijuana, and had sexual relationships with oil and gas company representatives.”

The investigation separately found that the programs manager mixed official and personal business. In sometimes lurid detail, the report also accuses him of having intimate relations with two subordinates, one of whom regularly sold him cocaine.

The culture of the organization “appeared to be devoid of both the ethical standards and internal controls sufficient to protect the integrity of this vital revenue-producing program,” one report said.

The director of the Minerals Management Service, Randall Luthi, said in a conference call with reporters that the officials implicated in the reports had violated the publics trust.

“When you come to work for the federal government, the American people expect the best of you,” he said, adding, “I am not going to leave this post in January without addressing this problem.” Mr. Luthi, who became the service director in July 2007, said that the agency had requested the investigation after receiving whistle-blower complaints in the spring of 2006, and that it had already made several changes. A spokesman for Mr. Devaney declined to comment.

A former official named in the report, Jimmy W. Mayberry, pleaded guilty to a felony conflict-of-interest charge in August and faces up to five years in prison and a $250,000 fine.

In late 2002, when he was about to retire, Mr. Mayberry drafted a "statement of work" for a consulting contract to perform essentially identical functions to his own. He then retired, started a company, and in June 2003 won the contract with the help of Ms. Denett and Milton Dial, another friend at the agency.

Danny Onorato, the lawyer representing Mr. Mayberry, said his client had a sentencing date in November, but added that "we are not interested in having Mr. Mayberry speak."

The inspector general also urged the administration to take action against several of the officials in the royalty-in-kind program who accepted gifts from the oil companies, by firing them or banning them for life from certain positions. Several have already been transferred out of the program but remain on the government payroll, the report said.

But two of the highest-ranking officials who were subjects of the investigations will apparently escape penalty. Both retired during the investigation, rendering them safe from any administrative punishment, and the Justice Department has declined to prosecute them on the charges suggested by the inspector general.

One of them is Ms. Denett, who oversaw the Denver-based royalty-in-kind program from Washington. The report contends that she manipulated the contracting process to steer the consulting work to Mr. Mayberry, her friend and former special assistant.

Six other companies submitted bids for the contract, spending more than $90,000 on their proposals. The report said an Interior Department procurement lawyer described the arrangement as one in which "the fix is in throughout—this is tainted from the beginning, that is totally improper."

Ms. Denett did not return a message left at her home on Wednesday with her husband, Paul A. Denett, who was the top procurement official in the White House Office of Management and Budget until he resigned this month. He declined to comment.

But the report quotes Ms. Denett repeatedly telling investigators that in retrospect she had made a "very poor" decision. She also told them that "she had been preoccupied with a very stressful personal issue at the time," which the report did not describe.

The other high-ranking official the Justice Department has declined to prosecute is Gregory W. Smith, the former program director of the royalty-in-kind program. Mr. Smith worked in Colorado and reported to Ms. Denett. He retired in 2007.

The report said that Mr. Smith improperly used his position with the royalty program to get an outside consulting job helping a technical services firm seek deals with oil and gas companies with which he was also conducting official business.

The report accused Mr. Smith of improperly accepting gifts from the oil and gas industry, of engaging in sex with two subordinates and of using cocaine that he purchased from his secretary or her boyfriend several times a year between 2002 and 2005. He sometimes asked for the drugs and received them in his office during work hours, the report said.

The report also said that Mr. Smith lied to investigators about these and other incidents, and that he urged the two women subordinates to mislead the investigators as well.

In discussions with investigators, the report said, Mr. Smith acknowledged buying cocaine from his secretary and having a sexual encounter with her at her home, but he denied discussing drugs at work. He also denied telling anyone to lie, saying that he only told people that "no one has a right to know what I do on my personal time."

The report omits any response from Mr. Smith about allegations of sexual misconduct with another female subordinate.

Mr. Smith on Wednesday referred questions to his lawyer, Steve Peters, who said he had not yet seen the report. But he lauded Mr. Smiths work with the royalty-in-kind program.

"Greg Smith was a loyal, dedicated employee of the federal government for more than 28 years, and notwithstanding the unfair and in many respects inaccurate allegations in todays report, Greg is very proud of what he accomplished—and he should be," Mr. Peters said. A Justice Department spokeswoman, Laura Sweeney, declined to explain why prosecutors chose not to bring charges against Ms. Denett or Mr. Smith, citing departmental policy.

The report also detailed cozy relationships between energy companies and other officials in the royalty-in-kind program office. Some 19 officials—a third of the staff—took gifts from oil and gas executives, some with "prodigious frequency," it said.

On one occasion in 2002, the report said, two of the officials who marketed taxpayers oil got so drunk at a daytime golfing event sponsored by Shell that they could not drive to their hotels and were put up in Shell-provided lodging. Two female employees "engaged in brief sexual relationships with industry contacts," the reports cover memo said, adding that "sexual relationships with prohibited sources cannot, by definition, be arms length."

On one occasion, the report said, the royalty-in-kind program allowed a Chevron representative who had won a bid to purchase some of the governments oil to pay taxpayers a lower amount than his winning offer because he said he had made a mistake in his calculations. A report from Mr. Devaneys office earlier this year found that the program had frequently allowed companies that purchased the oil and gas to revise their bids downward after they won contracts. It documented 118 such occasions that cost taxpayers about $4.4 million in all.

On another occasion, the new report said, one of the officials shared information about the confidential price a pipeline company was charging the government.

The report said that the officials told investigators that the gifts and socializing did not affect how they treated the companies in their official duties.

They also said they did not view socializing with oil company representatives and taking gifts as inappropriate because they said they needed to be part of the marketing culture in order to market the programs oil and gas. Several of the lower-ranking program officials have been transferred out of their old jobs, the report said. It recommended stronger supervision and a series of changes to make clearer the limits of acceptable behavior, some of which Mr. Luthi said have already been implemented.

A few nice quotes from the report of the Inspector General of the Interior Department.

During the course of our investigation, we learned that some RIK employees frequently consumed alcohol at industry functions, had used cocaine and marijuana, and had sexual relations with oil and gas company representatives.

Our investigation disclosed that alcohol was available at most or all of the industry events attended by RIK employees. For instance, we learned that two RIK employees who had attended a daytime industry-sponsored event had later spend the evening in lodging provided by that company because they were too intoxicated to safely drive to a nearby hotel.

When we interviewed the employees involved,they insisted that they were developing business relationships and had gathered valuable industry related information by attending this event.

Other witnesses we interviewed stated that RIK employees "partied" frequently with oil and gas industry representatives and that these two RIK marketers were commonly referred to by industry representatives as the "MMS Chicks." ,

According to the RIK employee, on more than one occasion, Smith directed her to purchase cocaine for him during normal MMS business hours, and Smith used the term "office supplies" when discussing cocaine while at work.

The RIK employee recalled that on one occasion in late 2004, Smith telephoned her repeatedly asking for drugs. She said she provided cocaine to him early that evening, but he continued to call her. Eventually, she said, Smith traveled to her house and wanted her to have sex with him. She said he also asked her if she had more cocaine, and she stated that she did not but that someone who was staying with her might. She said Smith obtained crystal methamphetamine from one of these individuals and she watched him snort it off the toaster oven in her kitchen. The RIK employee also said she and Smith engaged in oral sex that evening.