Highlights of GAO-08-289, a report to congressional requesters.

February 2008

UTILITY OVERSIGHT

Recent Changes in Law Call for Improved Vigilance by FERC

Why GAO Did This Study

Under the Public Utility Holding Company Act of 1935 (PUHCA 1935) and other laws, federal agencies and state commissions have traditionally regulated utilities to protect consumers from supply disruptions and unfair pricing. The Energy Policy Act of 2005 (EPAct) repealed PUHCA 1935, removing some limitations on the companies that could merge with or invest in utilities, leaving the Federal Energy Regulatory Commission (FERC), which already regulated utilities, with primary federal responsibility for regulating them. Because of the potential for new mergers or acquisitions between utilities and companies previously restricted from investing in utilities, there has been considerable interest in whether cross-subsidization—unfairly passing on to consumers the cost of transactions between utility companies and their "affiliates"—could occur. GAO was asked to (1) examine the extent to which FERC changed its merger and acquisition and post merger review and oversight processes since EPAct to protect against cross-subsidization and (2) survey state utility commissions about their oversight.

What GAO Recommends

GAO recommends that FERC use a risk-based approach to detect cross-subsidization, enhance audit reporting, and reassess resources to demonstrate oversight vigilance. While FERC's Chairman disagreed with GAO's findings and recommendations, GAO maintains they are sound.

For the full product, including scope and methodology, click on GAO-08-289. For the survey results, click on GAO-08-290SP. For more information, contact Mark Gaffigan at (202) 512-3841 or gaffiganm@gao.gov.

What GAO Found

FERC has made few substantive changes to either its merger review process or its postmerger oversight since EPAct and, as a result, does not have a strong basis for ensuring that harmful cross-subsidization does not occur. FERC officials told us that they plan to require merging companies to disclose existing or planned cross-subsidization and to certify in writing that they will not engage in cross-subsidization, but do not plan to independently verify such information. Once mergers have taken place, FERC intends to rely on its existing enforcement mechanisms—primarily companies' self-reporting noncompliance and a limited number of compliance audits—to detect potential cross-subsidization. FERC officials told us that they believe the threat of large fines, as allowed by EPAct, will encourage companies to investigate and self-report any non-compliance. In addition, FERC officials told us that, for 2008, FERC developed its plans to conduct compliance audits of 3 of the 36 holding companies it regulates based on informal discussions between senior agency officials and staffs in key offices. However, FERC does not formally use a risk based approach that considers factors, such as companies' financial condition or history of compliance. A risk-based audit approach is an important consideration in efficiently allocating its limited resources to detect non-compliance. In addition, we found that FERC's public audit reports often lacked a clear description of the audit objectives, scope, methodology, and findings—inhibiting their use in improving transparency with stakeholders or helping FERC staff improve their audit practices.

State utility commissions' views of their oversight capacity varied, but many reported a need for additional resources, such as staff and funding, to respond to changes in their oversight after the repeal of PUHCA 1935. State regulators in all but a few states reported that utilities must seek state approval for proposed mergers. State regulators reported being mostly concerned about the impact of mergers on customer rates, but 25 of 45 reporting states also noted concerns that the resulting, potentially more complex company could be more difficult to regulate. Most states reported having some type of audit authority over the transactions between utilities and their affiliated companies, but many states currently review or audit only a small percentage of these transactions, with 28 of the 49 reporting states auditing 1 percent or less over the last five years. On the other hand, some states reported that they require periodic, specialized audits of affiliate transactions. In addition, although almost all states require financial reports from utilities and report they have access to utility companies' financial books and records, many states reported they do not have such direct access to the books and records of affiliated companies. While EPAct provides state regulators the ability to obtain such information, some states expressed concern that this access is narrow and could require them to be extremely specific in identifying needed information, thus potentially limiting their audit access. From a resources perspective, 22 of the 50 states reporting said that they needed additional staffing and funding to a carry out their oversight responsibilities.