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Highlights

Highlights of GAO-08-752T, a testimony before the Committee on Energy and Natural Resources, U.S. Senate

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 The Energy Policy Act of 2005 (EPAct) repealed PUHCA 1935, removing some limitations on the companies that could merge with or invest in utilities, and leaving the Federal Energy Regulatory Commission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 testify on its February 2008 report, *Utility Oversight: Recent Changes in Law Call for Improved Vigilance by FERC* (GAO-08-289), which (1) examined the extent to which FERC changed its merger review and post merger oversight since EPAct to protect against cross-subsidization and (2) surveyed state utility commissions about their oversight. In this report, GAO recommended that FERC adopt a risk-based approach to auditing and improve its audit reports, among other things. The FERC Chairman disagreed with the need for our recommendations, but GAO maintains that implementing them would improve oversight.

To view the full product, including the scope and methodology, click on GAO-08-752T. For more information, contact Mark Gaffigan at (202) 512-3841 or gaffiganm@gao.gov.

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UTILITY REGULATION

Opportunities Exist to Improve Oversight

What GAO Found

In its February 2008 report, GAO reported that FERC had made few substantive changes to either its merger review process or its post merger 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 GAO that they plan to require merging companies to disclose any cross-subsidization and to certify in writing that they will not engage in unapproved cross-subsidization. After 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 the large fines allowed under EPAct will encourage companies to investigate and self-report noncompliance. To augment self-reporting, FERC officials told us that, in 2008, they are using an informal plan to reallocate their limited audit staff to audit the affiliate transactions of 3 of the 36 holding companies it regulates. In planning these compliance audits, FERC officials told us that they do not formally consider companies' risk for noncompliance—a factor that financial auditors and other experts told us is an important consideration in allocating audit resources. Rather, they rely on informal discussions between senior FERC managers and staff. Moreover, we found that FERC's audit reporting approach results in audit reports that often lack a clear description of the audit objectives, scope, methodology, and findings—inhibiting their use to stakeholders.

GAO's survey of state utility commissions found that states' views varied on their current regulatory capacities to review utility mergers and acquisitions and oversee affiliate transactions; however many states reported a need for additional resources, such as staff and funding, to respond to changes in oversight after the repeal of PUHCA 1935. All but a few states have the authority to approve mergers, but many states expressed concern about their ability to regulate the resulting companies. In recent years, two state commissions denied mergers, in part because of these concerns. Most states also have some type of authority to approve, review, and audit affiliate transactions, but many states review or audit only a small percentage of the transactions; 28 of the 49 states that responded to our survey question about auditing said they audited 1 percent or fewer transactions over the last five years. In addition, although almost all states reported that they had access to financial books and records from utilities to review affiliate transactions, many states reported they do not have such direct access to the books and records of holding companies or their affiliated companies. While EPAct provides state regulators the ability to obtain such information, some states expressed concern that this access could require them to be extremely specific in identifying needed information, thus potentially limiting their audit access. Finally, 22 of the 50 states that responded to our survey question about resources said that they need additional staffing or funding, or both, to respond to changes that resulted from EPAct, and 8 states have proposed or actually increased staffing since EPAct was enacted.