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STATEMENT OF VICTOR L. LOWE
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U.S. GENERAL ACCOUNTING OFFICE
BEFORE THE
SPECIAL SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
HOUSE OF REPRESENTATIVES
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Mr. Chairman and members of the subcommittee, my name is Victor L. Lowe, Director of the General Government Division of GAO. My division is responsible for carrying out GAO's audit activities at independent regulatory agencies, including the Federal Power Commission, and conducted the study undertaken at the request of Congressman John E. Moss that resulted in our September 13, 1974, report entitled "Need for Improving the Regulation of the Natural Gas Industry and Management of Internal Operations, Federal Power Commission."

Accompanying me today are Mr. Robert A. Peterson, Assistant Director, General Government Division; Mr. Ralph Lotkin, Office of General Counsel; and Mr. T. Vincent Griffith, Office of Congressional Relations.

Our report discusses a wide range of topics and our purpose in appearing here today is to summarize the principal findings and conclusions; discuss recent actions taken by FPC in response to the report; and respond to any questions the Subcommittee may have.

Initially I would like to focus on the one area where there is a fundamental difference of opinion between GAO and FPC. Namely

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the propriety of the extensions granted by FPC to producers selling gas in the interstate market pursuant to FPC's emergency regulations.

Background

In 1970 FPC issued a number of emergency orders designed to deal with perceived gas shortages. Two of these orders (orders 402 and 402A issued in May and June of 1970) permitted intrastate pipelines and distribution companies to make sales to interstate pipelines without prior approval of FPC for up to 60 days at unregulated rates. The orders also provided that if the emergency was expected to persist for longer than 60 days, the seller could obtain prior authorization from FPC to continue the sale for longer periods.

In December 1970, FPC issued Order 418. Order 418 added a new dimension to FPC's efforts to deal with the gas shortage by authorizing independent natural gas producers to make emergency sales to interstate pipelines for 60 days without prior FPC approval. We believe it significant that whereas Orders 402 and 402A clearly permitted sales for periods longer than 60 days, if approved in advance, the Commission explicitly rejected unregulated producer sales beyond the 60 day period specified in Order 418. Several parties suggested prior to issuance of Order 418 that the 60 day period be extended to periods ranging from 3 to 6 months. FPC rejected these suggestions and deferred disposition of the longer term emergency sales issue "until such time as we may propose additional rules applicable to emergency transactions on a more extended basis."

Despite this assuance, we found that as of December 31, 1973, FPC had approved 96 extensions to producers making 60 day emergency sales pursuant to Order 418, without issuing regulations authorizing such extensions as required by the Natural Gas Act. In our view FPC's actions were improper because the extensions were not authorized by FPC regulations, and because they run counter to FPC's stated intentions and clear commitment to limit emergency producer sales to 60 days until additional regulations were issued.

Let's examine the nature and purpose of the extensions. Most extensions -- 86 of 96 -- were granted to prevent interruptions in gas deliveries by producers who had been selling under Order 418 and who had also applied to FPC for a limited term certificate. A program of granting limited term certificates enabling producers to sell gas in the interstate market for a limited duration (usually less than three years) was initiated by FPC in April 1971. Unlike the emergency programs discussed previously, issuance of a certificate was predicated on a finding that the rate to be charged by the producer was just and reasonable.

<u>Extensions granted to companies applying for limited-term certificates</u>

On June 20, 1973, the Commission authorized the Secretary of FPC to grant 60-day extensions to those producers who were making

60-day emergency sales under Order 418 and who also had a pending application for a limited-term certificate. The purpose of the extensions was to prevent a forced interruption of service when action could not be taken on the application for limited-term certificate before expiration of the 60-day emergency sale.

In June 1973, the FPC General Counsel and the Chief, BNG, recommended that the extensions include a refund provision in case the producer withdrew his application or the FPC arrived at a lower price for sales under the limited term certificate.

Only one of the 86 extensions granted contained such a refund provision. Twenty-six producers did in fact withdraw their certificate applications after obtaining the extensions. Eight of the twenty-six producers immediately took advantage of FPC's 180-day emergency sales program (initiated by Order 491 in September 1973) and effectively sold gas for up to 300 days at unregulated rates. (60 days + 60 days + 180 days) The remaining eighteen producers terminated the sales at the expiration of the extension. Thus sales at unregulated rates were made for more than 60-days and the intended benefits of the extensions -- uninterrupted gas supplies -- were not realized.

A second group of extensions were granted for an entirely different purpose -- to cope with a court imposed stay of FPC's regulations implementing 180-day emergency sales. These extensions are particularly troublesome to GAO.

Extensions granted to cope with
court stay of Order 491

In September 1973, FPC issued Order 491 which extended from 60 to 180 days the period in which emergency sales could be made under Orders 402, 402A and 418.

On September 21, 1973, a suit was filed in Federal court by the Consumer Federation of America, *et al*, in opposition to Order 491 claiming that such action was *de facto* deregulation of the natural gas industry and that FPC's procedures in issuing Order 491 failed to comply with the requirements of the Administrative Procedure Act.

On September 26, 1973, FPC responded to the motion for stay of Order 491 filed with the court by the Consumer Federation of America, *et al*. In its response, the FPC presented data indicating what it believed to be an impending nationwide shortage of natural gas during the 1973-74 winter season. FPC advised the court that FPC's action in meeting this emergency represented a clear case in which the fulfillment of FPC's statutory duties required the interest of private litigants to give way to the realization of public purposes and requested the court to deny the motion for stay.

On October 3, 1973, the court stayed implementation of Order 491 pending final FPC action on a motion for reconsideration made by the Consumer Federation of America. FPC did not appeal this ruling.

About one month later, November 2, 1973 -- FPC, after considering the oposition of the Consumer Federation of America and others, issued Order 491-B reaffirming Order 491.

From October 3 to November 2, 1973, FPC approved extensions to 21 emergency sales entered into pursuant to Order 418. As noted previously, extensions were not authorized by Order 418. Furthermore, eight of the extensions granted were to companies that had no applications pending for limited-term certificates which was the only basis for an extension in the written delegation of authority given by the Commission to the Secretary.

We asked the Secretary, FPC, why extensions were granted to companies engaged in 60-day emergency sales when there were no pending applications for limited-term certificates. The Secretary said the Commission orally authorized him to grant extensions, even when limited-term certificate applications were not pending. The Secretary could not tell us exactly when this oral delegation of authority was made.

Order 491 provided that producers making 60-day sales could begin a new 180-day sale when the 60-day sale expired. The Chief, BNG, told us that, when the court stayed implementation of Order 491, FPC was faced with the problem of either forcing interruptions in the flow of gas or granting extensions under the 60-day order. According to the Chief, FPC was anticipating a severe gas shortage for the 1973-74 winter and stated that extending the 60-day sales was the only way it could get the gas.

It should be noted that the dilemma FPC found itself in was of its own doing. Had FPC issued the appropriate regulations when it first began to grant extensions to producer making 60-day emergency sales, the issues involved could have been settled by the time of the court imposed stay of Order 491 in September 1973.

In any event, when the court was not swayed by FPC's argument that the public interest required immediate authorization of emergency sales for longer than 60 days, it was incumbent on FPC to either appeal the court ruling imposing a stay of Order 491 or issue regulations permitting extensions of 60-day emergency producer sales. The granting of the eight extensions without exhausting other remedies, raises serious questions as to the propriety of FPC's actions. There is no question that the granting of extensions negated the effect of the court stay.

FPC disagrees with GAO claiming it has the authority to waive any regulation in appropriate circumstances and that its action in this instance was a legal and necessary step in the public interest.

When considering Order 418 the Commission specifically rejected the proposal that emergency producer sales be authorized for periods exceeding 60 days, deferring the question until additional regulations could be proposed. These additional regulations were embodied in Order 491, which the court saw fit to stay.

If the Commission has plenary authority to accomplish through the waiver of regulations what could not be accomplished through the issuance of formal regulations, then litigation by dissenting parties is futile and the regulatory process made a sham. We believe strongly that this issue needs to be resolved by the Congress and the courts.

Recent Actions Taken By FPC

To bring this discussion up to date, between March and June of 1974 the emergency programs to encourage interstate sales by gas producers were terminated. On September 9, 1974, FPC reinstated 60-day emergency sales and the limited term certificate program. In so doing the Commission made it clear that "it is in the public interest to strictly construe the provision limiting such operations to a single period of not more than sixty (60) days."

Under the new regulations a producer desiring to sell gas for a period in excess of 60 days must obtain a certificate authorizing such sales. In the event that certificate applications are not acted upon within 60 days, deliveries may be continued subject to refund of any amount collected in excess of the rate finally determined to be appropriate. We believe that these provisions have corrected the defects in the Commission's previous orders and practices.

A cloud remains, however, as to whether FPC has authority to waive these regulations, and if so, in what circumstances.

For our part, we believe FPC has not been conferred such authority by the Congress, nor do we see a need for such authority. The Natural Gas Act provided ample flexibility for the Commission to deal with unforseen situations through regulations. The major benefit of requiring FPC to act through regulations is that the public is kept informed. Thus, while corrective action has been taken to correct the previous situation, the issue of FPC's plenary authority still needs to be put to rest by the Congress to prevent future problems.

Emergency Gas Sales: Need for Complete and Accurate Data

Turning to a different subject, our examination disclosed a need for FPC to obtain more complete and accurate data on the volume and price of gas brought into the interstate market by its emergency sales programs. In its decision making processess FPC relied on incomplete data and estimates because it did not enforce the reporting requirements in orders 402 and 402A, did not include an appropriate reporting requirement in Order 418 and did not use all of the data in its possession. Moreover, the limited available information suggests that the estimates received by FPC were greater than the actual gas sales by a wide margin.

FPC agreed that actual price and volume data on emergency gas sales was needed. In this connection, when reinstating 60-day emergency producer sales in September 1974, FPC included a requirement that the buyer notify the Commission of the price and estimated volume to be delivered when the sale begins and, upon completion of the sale, advise the Commission of the actual volumes delivered and the price paid.

Collection of this type of data should greatly enhance FPC's ability to assess the efficacy of the emergency sales programs.

Need for Timely Action on Optional Certificate Applications

Our examination also disclosed a need for improving FPC's optional certificate procedures to insure that gas customers are charged prices that are just and reasonable.

In August 1972 FPC adopted the optional certificate procedure authorizing natural gas sales by producers at prices exceeding area ceiling rates, if found by FPC to be in the public interest. The procedure allows the delivery of gas to begin before final FPC action on the application, as long as the deliveries are made at rates no higher than the prevailing area ceiling rate for 6 months. At the end of the 6 months, if FPC has not entered its final order on the application, the producer, after filing a notice of change in rates with FPC, can charge the rates specified in the contract until FPC acts on the application.

Through March 5, 1974, the average time required for FPC to process applications under this procedure was about 8 months. As a consequence, customers have been charged higher rates than the applicable area rate while awaiting FPC action. FPC records showed that, FPC had not acted on 17 applications within 6 months and the producers received the contract price for gas before final FPC action on the applications. Of these 17, 1 was denied, 7 were still pending final resolution as of March 5, 1974, while the rest were approved. In the one case denied, the producer received about $828,000 more than the area rate before his application was denied by FPC. Under FPC regulations the $828,000 is not refundable.

As of March 5, 1974, the cost of gas sold under the seven applications pending final FPC action was about $1.4 million more than the amount that would have been charged under the prevailing area rate. Two of the seven applications had received initial decisions by FPC ALJs; both applications were denied. Though all seven applications may ultimately be approved by FPC, some may be denied. If an application is denied, the contract price being charged by the producer may not be just or reasonable thereby resulting in an overcharge to the gas customers.

On August 8, 1974, FPC issued a notice of proposed rulemaking that would extend from 6 to 9 months the period in which the area rate must apply before the producer can charge the contract price. If adopted this change will be an improvement over the previous regulation. However, without other improvements in the internal processing of applications the proposed regulation can only be partially effective.

While the average processing time of applications was 8 months, some took longer -- in fact up to about 15 months. For the regulations to be fully effective all applications will have to be processed in 9 months or less. FPC was unable to do this previously.

Breakdown in Safeguards to Prevent Conflict of Interests

Turning to another topic that has stirred considerable interest, our review found that there has been widespread non-compliance by FPC officials with the agency's standards of conduct regulations resulting from a breakdown in the reporting system intended to disclose financial holdings of officials that were actual or potential conflicts of interest. Most FPC officials had failed to file required financial disclosure forms for several years, including the officials responsible for obtaining and reviewing the disclosure forms. When officials made the required disclosures, no review was made to safeguard the agency and the officials from conflict of interest allegations.

Only about half of the 125 officials required to make a financial disclosure at the time of initial employment with FPC did so. Moreover, the content of the disclosures were never reviewed. Had the filings been examined it would have shown that some officials hald securities that were potential conflicts of interest. For the years 1971 through 1973 only a handful of FPC officials made the required annual financial disclosures at the time our review began:

-- 31 of 125 in 1973

-- 12 of 111 in 1972

-- 10 of 101 in 1971.

When the required 1973 disclosures were obtained and reviewed, 19 FPC officials were directed to divest themselves of securities found to be prohibited by FPC regulations.

We view this situation as a serious breakdown in the system intended to protect the agency and officials involved from allegations of conflict of interest.

A number of steps have been taken by FPC in line with the recommendations in our report to strengthen the financial disclosure system.

Other topics covered by the report include:

-- Public statements of FPC Commissioners

-- FPC pricing policies and their effect on gas supply and price

-- FPC cooperation with the Federal Trade Commission during its investigation of the natural gas industry

We will be pleased to respond to any questions the subcommittee may have.