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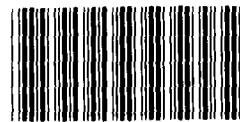
Report To The Chairman, Subcommittee On Energy, Nuclear Proliferation And Government Processes Committee On Governmental Affairs United States Senate

Lengthy Case Processing Causes Overlapping Of Electric Rate Increases

Overlapping of electric rate increases occurs because under law and regulation, utilities can take advantage of the Federal Energy Regulatory Commission's lengthy rate case processing time by filing successive applications for rate increases and putting them into effect while awaiting approval on previously filed applications.

This report discusses the

- extent of overlapping rate increase cases and associated problems,
- effect of such cases on investor-owned utilities and wholesale and retail customers, and
- efforts the Commission has taken to lessen or eliminate the impacts of overlapping rate increases.



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RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

B-211927

The Honorable Charles H. Percy
Chairman, Subcommittee on Energy,
Nuclear Proliferation and
Government Processes
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

In your March 8, 1982, letter you requested that we evaluate the effectiveness of the Federal Energy Regulatory Commission's (FERC's) response to the recommendations in our report entitled "Additional Management Improvements Are Needed to Speed Case Processing at the Federal Energy Regulatory Commission," EMD-80-54, July 15, 1980.¹ You also asked us to address the subject of "pancaking" of electric rate increases, which is the subject of this report. Pancaking is the stacking of one unadjudicated rate increase on top of another before FERC has approved them.

As agreed with your office, we are providing information on the extent of the problem of pancaking and what efforts FERC is making to eliminate it. Pancaking occurs because, pursuant to both the Federal Power Act and FERC's regulations, electric utilities can file successive applications for rate increases and put them into effect without awaiting FERC's approval on previously filed applications. The incidence of pancaking is also related to the prevailing economic conditions. During times of economic instability and high inflation, utilities are likely to more frequently file rate increase requests, thus increasing the chance that pancaking would occur. According to FERC's Director of Rate Regulation, utilities generally file rate increase requests annually, while FERC can take 2 to 4 years to resolve these rate increase cases. Thus, the successive rate increase requests stackup. However, if any portion of the rate increase is later found to be unjustified, FERC orders the utility to refund any unjustified charges plus interest to its customers. Refunds of \$175 million in overcharges plus interest were paid to wholesale customers in fiscal year 1982.

¹Our report entitled "Federal Energy Regulatory Commission Has Expedited Case Processing; Additional Improvements Needed," GAO/RCED-83-51, June 10, 1983, responded to this request.

Our review showed that, as discussed in our July 15, 1980, report, investor-owned utilities continue to file successive rate increase applications with FERC before obtaining FERC's approval of previously requested increases. Based on the latest available data, as of October 1, 1982, 28 cases totaling \$479 million involved pancaking. According to the American Public Power Association (APPA), which represents more than 1,400 municipals and other local, publicly owned electric utilities in 48 States, Puerto Rico, the Virgin Islands, and Guam, pancaking adversely affects wholesale customers because it is not only expensive and administratively burdensome to them but also can affect these firms' ability to compete with the investor-owned utilities for retail customers. Retail customers could be impacted because they could be paying unapproved rate increases without the assurance of receiving the refunded overcharges from the wholesalers.

FERC has implemented two policy changes and has issued two notices of proposed rulemaking to reduce refunds and shorten the processing time for rate increase cases. Although these are steps in the right direction, the opportunity to pancake rate increases will exist as long as FERC's case processing times exceed 1 year. During fiscal year 1982, FERC's average case processing time for electric rate cases was 27 months.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to prepare an informational report on the subject of pancaking, which would address

- the extent of pancaked rate increase cases and associated problems,
- the effect of pancaking on investor-owned utilities and wholesale and retail customers, and
- the efforts FERC made to lessen or eliminate the impacts of pancaked rate increases.

As agreed, we did not analyze individual rate increase cases or evaluate the relative merits of suggested remedies to eliminate pancaking because of time constraints.

The information in this report is based on interviews with FERC officials and representatives in the electric utility industry, including the APPA, six investor-owned utilities and six of their wholesale customers. We selected APPA because it represents a major portion of the Nation's wholesale electric customers. We arbitrarily selected the six investor-owned utilities and their six wholesale customers. Because these six utilities constitute only a very small percentage of the total number of

investor-owned utilities, their comments and opinions do not necessarily represent the views of all these utilities. We also examined reports, studies, and related documents on pancaked rate cases at FERC. Using the data in these documents, we developed statistics to show the total number and dollar amount of pancaked cases. In addition, we examined APPA documentation on pancaking. We have obtained agency comments on a draft of this report and they are included in appendix I.

BACKGROUND

FERC is responsible for regulating interstate wholesale electric rates under provisions of the Federal Power Act (16 U.S.C. 824 et. seq.), as amended. As a part of its regulatory responsibility, FERC must ensure that interstate wholesale electric power is offered at rates and under conditions that are just and reasonable.

A wholesale electric rate case involves a large investor-owned electric utility that sells power at wholesale to a distribution system or a group of distribution systems for resale. Most of these distribution systems are municipally or cooperatively owned. Investor-owned utilities may also sell electric power at retail. Of the 215 investor-owned utilities that FERC regulates, about 100 of them sell to distribution systems for resale. FERC considers these utilities' rate filings to be major rate increase cases.

When an investor-owned utility files for a wholesale rate increase, FERC can either allow the rate to be implemented or suspend (delay) the implementation for up to 5 months, at which time the rate goes into effect subject to refund of any part found not justified. If the proposed rate appears just and reasonable, FERC permits almost immediate implementation. If not, FERC generally suspends it for up to 5 months.

Wholesale rate increase cases are resolved by settlement agreement or FERC's opinion following formal hearings. Settlement conferences between parties may be held anytime before or during the hearings. FERC reviews the proposed settlements and approves them if they are just and reasonable and resolve the issues raised in the proceeding.

If an acceptable settlement cannot be reached, the case is entered into a formal hearing, which can result in a FERC opinion. An administrative law judge (ALJ) presides over the hearing and FERC staff, utility representatives, wholesale customers, and other interested parties participate. This process is similar to that followed in civil court cases in which testimony is taken and arguments are heard. The hearing phase continues until the ALJ reaches an initial decision on the rate

increase. FERC's Office of Opinions and Reviews review the ALJ's decision for compliance with FERC policy and then submits it to the Commission for a final review and decision. The hearing and subsequent review is a lengthy process and significantly contributes to the time it takes FERC to process a rate increase case, which can take from 24 to 48 months. During fiscal year 1982, the average caseload processing time was 27 months.

Pancaking of electric rate increases is a byproduct of FERC's lengthy case processing times. The Federal Power Act does not require that one rate increase case be resolved before another is submitted to FERC. As a result, an investor-owned electric utility can file proposed wholesale rate increases in successive years and put them into effect before a final decision has been made in the first case.

Pancaking of rate increases was not always a problem. Prior to 1970, there were few rate increase filings pending before the Federal Power Commission, FERC's predecessor. Economic conditions were fairly stable. However, the economic climate began to change in the early 1970's with inflation causing electric production costs to significantly increase. Also, interest rates rose sharply, fuel expenses and construction costs soared, and the imposition of environmental controls added unexpected costs. As a result, investor-owned utilities attempted to keep pace with these rising costs by increasing their wholesale rate increase filings at FERC.

FERC was not prepared to handle the increased number of rate increase applications. Its electric rate operation was small and its administrative procedures for processing rate cases had bottlenecks at each stage in the process. Therefore, it was difficult, if not impossible, to process cases in any reasonable time frame. We discussed these bottlenecks in our July 15, 1980, and June 10, 1983, reports.

CURRENT VOLUME OF PANCAKED CASES

Pancaking of rate increase cases at FERC has been occurring since at least 1974. Since then, the number of pancaked cases at FERC has fluctuated, although FERC does not have complete data on pancaking from 1974 to 1980. We were able, however, to obtain from FERC data on pancaked cases as of January 1, 1981, January 1, 1982, and October 1, 1982. The table below shows the number and dollar amount of pancaked cases pending at these dates. Each pancaked case means that an investor-owned electric utility has filed successive proposed wholesale rate increases and is permitted to implement each increase after a maximum of 5 months, irrespective of whether FERC has approved the previous rate increase.

Electric Rate Increase Cases
Pending in 1981 and 1982

<u>Date</u>	<u>Cases</u>			<u>Dollar amount (in millions)</u>		
	<u>Total</u>	<u>Pancaked</u>		<u>Total</u>	<u>Pancaked</u>	
		<u>Number</u>	<u>Percent</u>		<u>Amount</u>	<u>Percent</u>
1/1/81	91	30	33	\$760	\$356	47
1/1/82	84	24	29	749	325	43
10/1/82	80	28	35	906	479	53

Source: Derived from data furnished by FERC.

Although the number of utilities that submit applications varies from year to year, there are about 100 investor-owned electric utilities that annually file major rate increases. The above table shows that, although the total number of cases pending has decreased from 91 to 80 over the almost 2-year period, the number of pancaked cases has fluctuated, and the percentage of such cases has risen from 33 percent to 35 percent in this period.

THE IMPACT OF PANCAKING

Pancaking has a positive effect on investor-owned utilities but detrimentally affects wholesale and retail customers. Because investor-owned electric utilities are requesting and implementing the wholesale rate increases that result in pancaking, the impact on them is positive. In fact, utilities consider these increases essential to their financial stability. According to the six investor-owned utility rate managers we contacted, pancaking of wholesale rate increases is a necessity in an inflationary climate. They told us that, given the length of time (2 to 4 years) it takes FERC to process rate increase cases, their companies' financial positions would seriously deteriorate if they had to wait for final approval before implementing the increased rates, particularly during times of inflation and when powerplants, which require significant amounts of funding, are being brought on line. One utility estimated that its 1982 revenue would have been \$14 million (4 percent of its total revenue) less if it had not been allowed to pancake.

Although the initial effect of pancaking on investor-owned utilities is positive, it could be partially offset by later refunds of the unapproved portion of the rate increase plus interest. (See p. 9.) These utilities' rate services managers told us that, in their opinion, pancaking will continue to be a problem as long as FERC takes longer than 12 months to process wholesale rate increase cases.

Pancaking has a detrimental effect on wholesale customers according to APPA's March 1979 testimony before a congressional committee. APPA said that pancaking creates financial and administrative problems for the wholesale customers and can harm their ability to compete with the investor-owned utility, from whom they purchase electric service, for new retail customers. In February 1983 the Legislative Director and Legislative Counsel of APPA told us that pancaking continues to be a problem for wholesale customers and that the information given in APPA's March 1979 testimony about the detrimental effect of pancaking on wholesale customers is still valid.²

According to APPA's 1979 testimony, the financial and administrative problems resulting from pancaking are due to the uncertainty of what the actual wholesale rate will be when finally decided by FERC. Since there is the possibility that FERC will require the initially implemented rate to be lowered, the wholesale customers could be faced with adjusting their rate schedules twice for a single rate increase--once when the rate is initially implemented and again if FERC orders that rate lowered. Each successive unapproved rate increase compounds this problem.

Wholesale electric rate increase cases are often complicated and strongly contested by wholesale customers. Therefore, intervening in a proceeding to protest a rate increase is costly and time consuming, particularly for those cases which are lengthy, such as those involving pancaking. A public utility commission official told us that intervention expenses for the 20 municipals under its jurisdiction is about \$350,000 annually. APPA's Legislative Director and Legislative Counsel told us wholesale customers must obtain permission and funds from their regulatory bodies to intervene in a rate case. Intervention in rate increase cases is time consuming because wholesale customers must compile evidence to support their positions, prepare their testimonies, and prepare for responses to cross examination on the issues in the rate case proceeding. This intervention produces voluminous records that have to be analyzed. It, in turn, impacts on the other parties to the proceedings.

²In our opinion, the adverse impacts the APPA described can also be experienced during rate case proceedings which do not involve pancaking. However, the degree of impact is magnified if the case involves pancaking because pancaked cases are in process longer than the other cases. Therefore, the parties to the case, for example, investor-owned utility and wholesale customers, expend more resources to participate in the proceedings than if the case were resolved in a shorter time.

According to APPA, another effect of pancaking is that it can result in anticompetitive rates for the wholesale customers, with a resulting price squeeze. Price squeeze applies to situations where an investor-owned utility is both supplier to the wholesale customer and its competitor at the retail level. A price squeeze exists if the utility's price for wholesale service is higher in relation to wholesale costs than is the utility's price for retail service in relation to its retail costs, so that the wholesale profit margin is higher than the retail profit margin. This situation results in actual or potential impairment of the wholesale customer's ability to compete with its wholesale supplier at the retail level. An actual example of this situation is documented in the court case of City of Mishawaka v. American Electric Power Co.³ Ten municipalities, owning their own electric utility system, filed suit against their wholesale supplier, Indiana and Michigan Electric Power Company alleging that the successive, unapproved wholesale rates charged by the Indiana and Michigan Electric Power Company had forced the municipalities to pay rates higher than rates for comparable service charged by the utility to its retail customers. The district court found that these anticompetitive practices impaired the municipalities' ability to operate their utilities and that they were entitled to receive damages.

The Legislative Director and Legislative Counsel of APPA believes that amending the Federal Power Act is the only way to prevent both pancaking and the imposition of electric rates which FERC has not yet approved. This proposal could, however, have a significant, adverse financial impact on investor-owned utilities, especially if FERC's case processing time remains at 2 to 4 years.

The pancaking of wholesale rate increases also has a detrimental effect on retail customers because rate increases that have not yet been approved by FERC are passed on to them. Consequently, retail customers may be paying unapproved rates for electric power for several years under pancaked filings and never have the assurance of receiving refunds for any overpayments from the wholesalers.

FERC does not have the legal authority to regulate the distribution of refunds to retail customers. Even some of the States do not have this regulatory responsibility because only about 50 percent of the States regulate municipals and cooperatives. In the remaining States, local regulatory bodies govern these entities. FERC does require utilities making refunds to

³465 F. Supp. 1320 (N.D. Ind. 1979), Modified on Measure of Damages, 616 F. 2d 976 (7th Cir. 1980), Cert. denied, 449 U.S. 1096 (1981).

notify the appropriate regulatory agencies of the amounts of refunds being made to their wholesale customers, so that the agencies, in turn, may order the refunds to be passed on to retail customers. According to FERC's Director of Electric Rate Regulation, cooperatives could either refund the overcharges to their customers or transfer the money to the local government for its use. A rate services manager of one municipal told us that refunds to his municipal for overcharges were not distributed to its retail customers but rather were invested by the municipal as a hedge against future rate increases.

REFUNDS ORDERED BY FERC

As shown in the following table, refunds ordered by FERC totaling \$573 million have been made to wholesale customers over the past 5 years, including \$175 million in fiscal year 1982. The refunds consist of the unapproved portion of the rate increases that the investor-owned utility collected, plus interest.

Cases With Refunds For Fiscal Years 1978 to 1982

<u>Fiscal</u> <u>year</u>	<u>Number of</u> <u>refunds</u>	<u>Amount of refunds</u> <u>ordered</u> (in millions)
1978	45	\$ 87
1979	(a)	69
1980	52	90
1981	39	152
1982	71	<u>175</u>
Total		<u>\$573</u>

a/Data not available.

Source: Derived from data furnished by FERC.

FERC does not separately identify pancaked cases in its refund reports. Therefore, we were unable to determine what portion of the refunds shown in the above schedule involved pancaked rate increase cases. However, based on our comparison of selected pancaked case file numbers with the case numbers in the refund reports from fiscal year 1978 through fiscal year 1982, we were able to identify some pancaked cases in which refunds were ordered, as shown below.

Examples of Pancaked Cases With Overcharge Refunds

<u>Year filed</u>	<u>Amount of increase collected</u>	<u>Date of refund</u>	<u>Amount of refund</u>	<u>Refund as a percent of requested increase</u>	<u>Interest on overcharges (note a)</u>	<u>Total refund</u>
1976	\$55,948,137	4/80	\$23,059,219	41	\$6,018,296	\$29,077,515
1978	13,333,746	2/80	5,483,501	41	433,013	5,916,514
1979	104,989	6/80	20,978	20	4,425	25,403

a/Interest on refunds is computed at the prevailing market rate to act as a deterrent to excessive rate increase proposals.

Source: Derived from data furnished by FERC.

As shown in the above table, the amount of overcharges collected by investor-owned utilities from their wholesale customers can be significant. In two of the cases, the refunds represented 41 percent of the requested increase collected. With the addition of interest, the total refund in these two cases was between 44 and 52 percent of the total increase collected.

FERC'S ACTIONS TO REDUCE PANCAKING

FERC has instituted policy changes and has issued one final and two proposed rulemakings aimed at reducing the length of time utility customers are paying unapproved rates. The policy changes encourage settlement agreements and establish a consistent rate suspension policy through the use of its computerized rate analyses.

On June 13, 1979, FERC issued Order No. 32, "Procedure for Submission of Settlement Agreements." The purpose of the rule was to (1) define in FERC's regulations the information to be included in offers of settlement and (2) prescribe procedures that would enable FERC to expedite consideration of settlements. By expanding upon its existing rules regarding settlements and stressing the importance of voluntary settlements, FERC believes that participants in a proceeding would increasingly seek the benefit of the settlement process to avoid the alternative of costly and often lengthy litigation before FERC.

As pointed out in our June 10, 1983, report to you on case-load processing, the former Chairman, FERC, directed the FERC staff to schedule uncontested settlements (settlements to which all parties agree) on FERC's agenda within 30 days of the proposed settlements and contested settlements within 60 days. These settlements include both electric rate and other types of

cases. Even though compliance was voluntary and no deadline was set on how quickly FERC would issue a final decision on those cases, we found that FERC generally has improved the timeliness of its decisions on settlements. For example, as of April 20, 1979, 71 settlements were pending FERC action, including 17 that had been pending for over a year. By December 1, 1979, FERC records showed only 41 pending settlements with none over a year old. More recently, of the 71 settlements (including 45 electric rate cases) decided in the 1-year period ended April 30, 1982, none were over a year old and all but 9 were decided within 60 days. FERC's Director of Electric Rate Regulation told us that currently about 80 percent of the major electric rate increase cases are settled before either an ALJ's initial decision or FERC's opinion is needed in the hearing process. During fiscal year 1982, 95 electric rate increase cases were resolved which would mean that about 76 (80 percent) were resolved by settlement agreement.

In February 1982 FERC established a consistent rate suspension policy to be used with its computerized analysis of rate increase filings. FERC has made available to the utilities the software package which contains its rate computation methodology for determining the just and reasonable rate. If the investor-owned utility's proposed rate increase is within 10 percent of FERC's computer analysis rate, FERC will allow the proposed rate to be implemented after only a 1-day suspension. If the rate request exceeds the 10 percent criterion, the proposed rate is suspended for 5 months, during which time the utility cannot collect the increased rate.

During FERC's 1983 appropriations hearings, the Chairman, FERC, stated that the computerized rate analysis helps to reduce the incidence of refunds, for its use can substantially shorten the period of time cases are in process and lessen the chances of investor-owned utilities requesting excessive rate increases. He believes that the consistent rate suspension policy will encourage the utilities to file more reasonable rate increase requests, which FERC can process more quickly.

In commenting on a draft of this report, the Executive Director stated that, in addition to the policies mentioned above, FERC summarily disposes of those rate making issues where there are no questions of law or fact. During our review of selected FERC orders on electric rate increases, we noted such summary dispositions. As a result of this procedure, the utilities must reduce their proposed rate changes to appropriately reflect FERC's policy and precedent. FERC believes that this procedure should reduce the amount of rate increases paid by wholesale customers, but later found unjustified by FERC.

The two proposed rulemakings that FERC has issued to help reduce rate case processing time and thus the incidence of pancaking are RM 80-36, Generic Determination of Rate of Return on Common Equity for Electric Utilities, August 26, 1982, and RM 83-1, Rules of Practice and Procedure: Reconsideration of Initial Decisions, November 19, 1982.

The proposal for the generic determination of rate of return on common equity is designed to simplify and speedup FERC's processing of wholesale electric rate cases and improve FERC's ability to accurately estimate how much it costs utilities to raise capital. The new procedure would replace FERC's current case-by-case approach in setting allowed rates of return--the issue most often contested in proposed rate increase cases.

Under the proposed rule, FERC would divide electric utilities into three groups based on relative investment risks. Base year rates of return for each group would be determined for 2-year intervals and a quarterly indexing procedure would be established. These generically determined rates of return for each group would only be applied to individual rate cases in which the rate of return issue is not resolved by agreement of the parties. Currently, FERC is reviewing this proposed rule.

FERC's other notice of proposed rulemaking would permit the ALJ to reconsider initial decisions and is designed to speedup decisionmaking for designated wholesale electric rate cases. The rule will apply only to those cases that do not involve major policy issues or novel questions of law or fact. The presiding ALJ would have the opportunity to clarify or correct ambiguities or errors in the initial decision and FERC would summarily affirm all or a portion of these decisions. Under current regulations, the ALJ does not have the authority to correct or clarify an initial decision before it is presented to FERC. FERC anticipates that the reduction in the number of full FERC reviews will substantially save processing time and expense for FERC and its staff; the other hearing participants; and ultimately, the rate-paying public. FERC also anticipates that this could result in routine electric rate cases being decided within 1 year from the date the matter is set for hearing. FERC is currently evaluating public comments on this proposed rulemaking.

In his comments on a draft of this report, the Executive Director stated that FERC's rule on construction work in progress issued May 16, 1983, should over the long term reduce the number of pancaked rate applications awaiting final FERC action. This rule allows utilities to include up to 50 percent of their construction work in progress in their rate base. In our opinion, it is too early to determine whether this rule will reduce the number of pancaked rate applications.

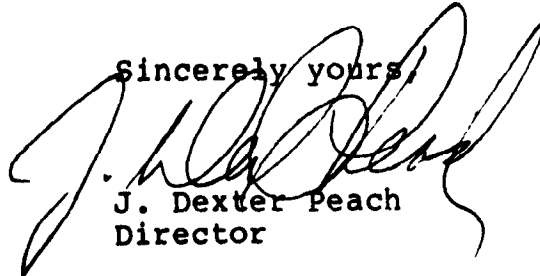
AGENCY COMMENTS

In his June 23, 1983, comments on our draft report, the Executive Director, FERC, pointed out several areas needing clarification or elaboration. We made changes to the report to recognize these comments. In particular, he believed that the report did not recognize, in addition to FERC's lengthy case processing time, the extraneous causes of pancaking, namely the ability of the utilities to choose when to file for rate increases and the prevailing economic conditions. We agree that there are extraneous causes of pancaking. We believe that our draft recognized these causes through the discussion of the impact of prevailing economic conditions on the incidence of pancaking.

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At your request, unless you publicly announce its contents earlier, we plan no further distribution of this report until 14 days from the date of the report. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

A handwritten signature in black ink, appearing to read "J. Dexter Peach", is written over the typed name and title.

J. Dexter Peach
Director

FEDERAL ENERGY REGULATORY COMMISSION

WASHINGTON 20426

IN REPLY REFER TO:

JUN 23 1983

Mr. J. Dexter Peach
Director
Resources, Community and
Economic Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

We have reviewed the draft report entitled, "Delays in Case Processing Cause Overlapping of Rate Increases." In response to your request, we offer the following comments.

The major thrust of the draft report is that pancaking of electric rate increases is solely the product of FERC's lengthy case processing time. While we do not disagree that there is a relationship between processing time and pancaking, there are also extraneous causes of pancaking. Under the Federal Power Act, a utility is free to file for rate increases with few restrictions. In periods of economic instability and high inflation, some utilities file as many as three increases in a two-year period. This also happens if utilities have several new generating units sequentially going on line over a period of a few months or years. In these situations, even if these cases proceed promptly through litigation, it may be impossible to eliminate pancaking. However, in a stable period of low inflation, or if utilities are allowed significant amounts of construction work in progress in rate base, the frequency of filings may be less. In these circumstances pancaking is likely to be less of a problem. We believe that pancaking is the result not only of FERC case processing time but of the ability of utilities to pick and choose when to file for rate increases and the prevailing economic conditions. While FERC can do little about external effects on pancaking, it has taken steps to deal with the internal causes and effects of pancaking. (GAO COMMENT: See p. 1.)

In addition to the policies mentioned in the study, the Commission has followed an administrative policy of summary disposition of those rate making issues where there are no questions of law or fact. This means that even before utilities begin collecting rate applications set for investigation, the rate changes must be reduced to reflect policy and precedent appropriately. This procedure should work to reduce the severity of any excess revenues collected from customers pending final Commission action on the rate (GAO COMMENT: See p. 10.)

See GAO note on p. 3 of appendix.

applications. The Commission has also recently issued Order No. 298 (May 6, 1983) which permits utilities to include up to 50 percent of their construction work in progress in jurisdictional rate base. This rule, over the long term, should work to reduce the number of pancaked rate applications awaiting final Commission action. (GAO COMMENT: See p. 11.)

The definition of price squeeze on page 7 of the draft report is incomplete. Price squeeze encompasses both prices and costs. A price squeeze exists if the utility's price for wholesale service is higher in relation to wholesale costs than is the utility's price for retail service in relation to its retail costs, so that the wholesale profit margin is higher than the retail profit margin. A price squeeze may exist even though wholesale rates are lower than retail rates. (GAO COMMENT: See p. 7.)

The discussion in the draft report concerning suspension policy is misleading. The Commission has used computerized analysis of rate increase filings since the mid-1970's. The importance of the February 1982 order was that the Commission outlined and made public the procedures that it would follow in evaluating rate increases for suspension purposes. While it is a fact that more copies of the staff's cost of service program have been sold since February 1982, the cost of service program was first offered for sale in May 1978. (GAO COMMENT: See p. 10.)

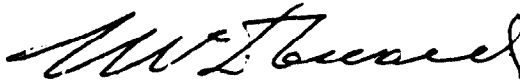
The discussion of the refunds of excess revenues collected under pancaked rate filings is also incomplete in that it fails to note that the interest on such refunds is computed at the prevailing market rate to act as a deterrent to excessive rate change proposals. The report further fails to note that the utilities making such refunds must notify the appropriate state or local regulatory agencies of the amounts of such refunds and associated interest so that the agencies, in turn, may order the refunds to be passed on to retail customers. (GAO COMMENT: See pp. 7-9.)

The draft report states that the rulemaking for determining the return on common equity is being changed based on comments received by the FERC. While it is the case that the comments on this rulemaking are being evaluated, it is premature to comment on the rule at this stage of the proceedings. (GAO COMMENT: See p. 11.)

The heading of the second column of the table on refunds on page 8 should read "Number of Refunds." The figures on refunds include amounts that resulted from the Commission granting summary disposition of a part of a suspended rate increase. Refunds from Order 84 compliance filings are, also, included in the amount. The heading of the second column in (GAO COMMENT: See p. 8.)

the second table on page 13 is for annual amounts. The heading for the fourth column is not for an annual amount but for amounts for a number of years. As column 2 represents an annual amount and column 4 represents multi-year amounts, the percent increases are inappropriate. (GAO COMMENT: See p. 9.)

Sincerely,



William G. McDonald
Executive Director

GAO note: Page numbers in this appendix have been changed to correspond to page numbers in this final report.

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